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Politics this week

Jun 6th 2002
From The Economist print edition

What next?

AP

Israel mounted fresh incursions in the West Bank after a bus carrying soldiers and civilians was blown up by a **car-bomb** in Megiddo in northern Israel. Seventeen Israelis were killed in the blast; Islamic Jihad, a militant Palestinian faction, claimed responsibility. It came as Israel's prime minister and Egypt's president were setting off for talks in Washington.

See article: After the carnage at Megiddo

Several villages were swamped and at least 20 people killed when a dam burst in northern **Syria**.

The rule of law took a knock in **Malawi**, when President Bakili Muluzi said he would ignore a court ruling that his ban on street demonstrations was unconstitutional. Mr Muluzi is seeking to amend the constitution to allow himself a third term in office, and has ordered police to arrest those who publicly object.

Police in **Zimbabwe** arrested two prominent lawyers on suspicion of seeking to foment violent protests against the rule of President Robert Mugabe. This follows the arrest of 12 independent journalists since Mr Mugabe claimed to win the election in March.

Hansie Cronje, a once-respected South African cricket captain who was banned from the game in 2000 after admitting taking bribes to throw matches, died in a plane crash.

Intelligence questions

The intelligence committees of the United States Senate and the House of Representatives began secret hearings on the **intelligence failures** surrounding the September 11th terrorist attacks. In yet another embarrassment for America's intelligence agencies, it emerged that the CIA had detailed knowledge of a meeting of al-Qaeda operatives, including two of the September 11th hijackers, in Kuala Lumpur before the attacks, but neglected to pass the information on properly to other agencies.

See article: Yet another September 11th intelligence failure

A committee of **Catholic bishops** proposed that all priests found abusing minors in future should be removed from the ministry, but did not go as far as recommending removal for any past abuse. The proposal will be voted on at the bishops' half-yearly conference in Dallas on June 13th.

See article: A proposal for dealing with sexual abuse by priests

Elizabethan Britain

AP

Queen Elizabeth II celebrated her **golden jubilee** on the throne of the United Kingdom. Unexpectedly large crowds flocked to central London for four days of festivities including pop and classical concerts and parades to mark her 50-year reign.

Germany's ruling Social Democrats, in their last party conference before the general election due in September, gave the chancellor, **Gerhard Schröder**, a strong show of confidence.

Russian MPs voted to make the use of the Cyrillic alphabet mandatory throughout the country, particularly annoying Tatarstan, a republic inside **Russia** that has switched to Latin script.

Denmark's centre-right coalition government, which relies in parliament on an anti-immigration party, brought in a package of tough new laws to curb immigration and reduce welfare benefits to newcomers.

See article: A restrictive new Danish immigration law

A growing number of prominent **Turks** said that their prime minister, Bulent Ecevit, should step down because of his ill-health.

AP

See article: Can Turkey's government survive?

Greece's trade unions said that they would call a general strike in protest against the Socialist government's plans to reform pensions and welfare.

Spain's government, backed by the Socialist opposition and Catalan nationalists, passed a law to ban Batasuna, the political arm of the **Basque** separatist terrorist group ETA, but three leading Basque bishops criticised the move.

See article: Spain's government tries to silence terrorist supporters

Amid protests from **Northern Ireland's** Protestants, Belfast's city council elected a member of Sinn Fein, the IRA's political wing, as the provincial capital's ceremonial lord mayor.

Kashmir crisis

As India and Pakistan exchanged fire from armoured vehicles for the first time in their latest conflict over **Kashmir**, the United States and other countries advised their nationals to leave the subcontinent. President George Bush telephoned both countries' leaders to urge restraint, and sent his defence secretary, Donald Rumsfeld, on a mission to the region.

See article: Conflict in Kashmir

A week before the convening of a *loya jirga* to choose a new government for **Afghanistan**, the United States said that “a significant presence” of al-Qaeda fighters remained at large in the country.

See article: A progress report on Afghanistan

Kim Hong Gul, a son of President Kim Dae Jung of **South Korea**, was charged with taking bribes of $2.9m in exchange for favours, and with evading taxes.

See article: South Korea's disgraced presidencies

The European Union and Japan ratified the **Kyoto Protocol**, a UN treaty on global warming that George Bush rejected last year. Meanwhile, environmental groups hailed a new American government report as signifying a shift in that sceptical stance, but Mr Bush denied any change in the administration's attitude.

Canada's rivals

Canada's prime minister, Jean Chrétien, fired his long-term finance minister and rival, Paul Martin, transferring the portfolio to John Manley, the deputy prime minister. Mr Martin is expected to launch a campaign to win the Liberal Party leadership.

See article: Civil war in Canada's ruling party

Argentina's government got Santa Fe province, the third of the big three, to promise to cut its public deficit, opening the way to fresh talks—though not just yet—with the IMF. Earlier, the IMF flew to the rescue of Uruguay, threatened with a bank run in the wake of Argentina's troubles. Brazil's *real* hit trouble, thanks mainly to its own, left-favouring election prospects.

See article: Uruguay and Argentina

EPA

The heaviest **rain** ever recorded there, 125mm in 24 hours, struck Chile. But Mexico's president, Vicente Fox, had to postpone a visit to the United States: his drought-hit country owes Texas farmers some 2,000 billion litres (over 1.5m acre-feet) of water which, under an ancient accord, it should have released into the Rio Grande and has not.

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Business this week

Jun 6th 2002
From The Economist print edition

Privatised companies may no longer be protected

Europe's governments may no longer be able to protect privatised companies from takeover bids. A judgment by the European Court of Justice barred the use of "**golden shares**" in former state enterprises to allow governments to block takeovers. The ruling may help to win agreement on a European Union takeover directive, which would establish common rules for the single market.

See article: Takeovers in the European Union

Telecoms companies with healthier finances hovered ready to snap up the prime assets of **KPNQwest**, after the Dutch telecoms company filed for bankruptcy. America's AT&T admitted that it had its eyes on some parts of the company; it had pulled out of a bid for the whole firm, triggering the bankruptcy.

Jean-Marie Messier, the embattled and unpopular boss of **Vivendi Universal**, picked up a salary of *euro*5.1m ($4.6m) in the past year, including a 250% bonus paid a short time after the French media giant announced record losses of *euro*13.6 billion for the year.

See article: Vivendi in trouble

AP

Art of management

Dennis Kozlowski was forced to resign as chairman and chief executive of Tyco, an acquisitive Bermuda-based conglomerate, shortly before being charged with tax evasion and related offences by New York authorities in connection with the purchase of valuable impressionist paintings. Tyco's shares tanked after the departure of Mr Kozlowski; previously shareholders had hoped that his dismissal might buck the firm up.

See article: Tyco's troubles

El Paso, an American gas company, saw its shares fall by 25% after the apparent suicide of Charles Dana Rice, the firm's treasurer, intensifying doubts about the company's finances. Like Enron, El Paso was found to have shifted debt off its balance sheet, but the company insisted that it had nothing else to hide.

HP (ex-Hewlett-Packard) vaunted its $19 billion takeover of Compaq Computer by announcing that cost savings would exceed previous estimates. Greater synergies than expected and faster job-cutting were given as reasons. Some 15,000 jobs will go over the next two years, 10% of the workforce.

Hitachi, Japan's leading electronics firm, is to buy **IBM's** loss-making hard-drive business for just over $2 billion. Hitachi promises to make it profitable, but observers question the high price. IBM was relieved to get shot of such a poor performer; Hitachi expressed pleasure at acquiring the business. Investors begged to differ, and Hitachi's shares dipped.

Bristol-Myers Squibb was sued by 29 American states for obstructing cheaper generic competition to Taxol, the American drug firm's blockbuster cancer treatment. The company is already defending a similar action over BuSpar, its anti-anxiety drug.

See article: Lawsuits over drug prices

Private party

Two Swiss private banks, **Lombard Odier** and **Darier Hentsch**, said that they would merge 200 years after their foundation, in order to cut costs and stay competitive with larger institutions. Swiss banking-secrecy laws make these institutions popular with the filthy rich, who wish to handle their cash out of sight of various authorities.

See article: Swiss private banks merge

John Rusnak was charged with fraud and other offences over his involvement in a foreign-currency dealing scandal at Allfirst Bank, an American subsidiary of Allied Irish Banks. The rogue trader lost the bank $691m.

Hicks, Muse, Tate & Furst, an American private-equity company, made a big-name signing to advise on politics and the world economy: **Henry Kissinger**, a former American secretary of state. In return for an undisclosed but no doubt sizeable chunk of cash he will adorn the firm with an illustrious reputation and intellect.

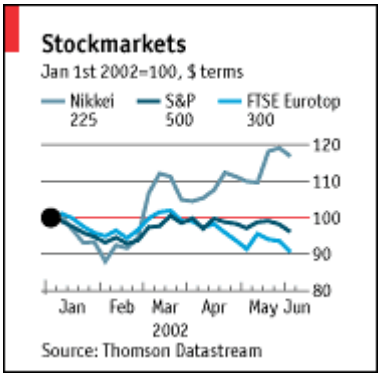
Dollar down

The **dollar** continued its slide against the world's big currencies, hitting a 17-month low against the euro, as investors dumped their bucks. The dollar held up against the yen, however, after fresh intervention by the Bank of Japan.

See article: The dollar weakens

Stockmarkets mostly fell. The Dow Jones Industrial Average hit a four-month low, dropping by as much as 2.2% in one day; and the tech-heavy Nasdaq also suffered.

Japan's government, stung by a downgrade of its credit rating by Moody's to the same level as Greece (and below Botswana), reacted by launching a campaign, fronted by a former beauty queen, to sell government bonds to domestic retail investors.



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American capital markets

The wickedness of Wall Street

Jun 6th 2002
From The Economist print edition

An overreaction to it poses risks for America's highly successful equity markets

THE backlash has been surprisingly slow in coming. Twenty-seven months have passed since the Nasdaq stockmarket bubble burst so spectacularly, and even longer since the Dow Jones Industrial Average peaked. But three developments have recently come together to cast America's capital markets, for so long the envy of the world, in a peculiarly unfavourable light—and to fuel calls for wholesale reform.

One is simply that, despite an apparent improvement in America's economic prospects, equity markets have been falling once again. This has punctured any lingering hopes that this bear market might prove short-lived. Then there are the continuing reverberations from the troubles of Enron, Global Crossing, WorldCom and (this week's casualty) Tyco, plus a string of lesser company meltdowns, which have directed new attention to the ills of personal greed, lousy accounts and inadequate surveillance. And there has been a series of assaults on Wall Street by regulators, politicians and lawyers, which have focused on conflicts of interest and other sins that seem inherent to stockmarkets and investment banks.

Trust, but verify

These three factors have helped to create an impression among investors that America's capital markets are in some way fundamentally biased against their interests. The consequence has been a loss of trust that now needs to be won back.

Does Wall Street need a shake-up? In some respects, yes. The excesses of the 1990s stockmarket bubble were not pretty. Ever-rising share prices encouraged companies to stuff their bosses' pockets with cash and stock options. Corporate America dived headlong into a new wave of mergers, often paying over the odds and becoming heavily indebted as a result. Carried away by Internet mania and the nirvana of the “new economy”, investors piled into companies with farcical business plans and little or no profit potential. The media, especially the business and technology press and financial chat-shows on television, played its own dishonourable part in helping to inflate the bubble.

But over it all bestrode the arrogant investment bankers of Wall Street. They subtly pressed on their clients seductive arguments for lucrative (for them, at least) mergers and initial public offerings. They exploited their supposedly independent research analysts to peddle dubious shares to gullible investors. They fervently preached the gospel of the new economy and its productivity miracle. And all the while they made a tidy heap for themselves, even when investors lost a bundle.

It is little wonder that there should now be demands for retribution, compensation and change (see article). And there are many things that should be done to improve Wall Street and America's capital markets more generally. The most important is to improve standards of disclosure. This means, in part, demanding that more is disclosed: potential conflicts of interest, trading activities, client relationships, market-sensitive news of all kinds. But it is more vital still to improve the quality, accuracy and relevance of what is disclosed: company accounts, above all, but broader financial data and other information as well. Corporate governance also needs revisiting, with a stronger role demanded of independent directors and more accountability imposed on bosses.

The upshot is a large agenda for the Securities and Exchange Commission, under its newish chairman,

Harvey Pitt. Mr Pitt's short tenure in the job has been mired in controversy. He has seemed slow to respond to the catalogue of scandals and complaints of the past year or so. He has allowed others—stock-exchange leaders, ambitious congressmen, publicity-seeking state attorneys-general—to usurp the SEC's proper role of policing and regulating America's capital markets. As a former securities lawyer representing big accounting firms, among others, he has himself been seen to be riven by conflicts of interest. Some commentators have already written off Mr Pitt and called for his departure.

Pitt the reformer

Yet it would be premature to reach such a judgment. It will take time and careful consideration to get right the changes needed to make America's capital markets more transparent, more honest and more efficient. Mr Pitt should certainly make greater efforts to sell his reform agenda; but a cautious approach may be more sensible than the dashing raids on banks' coffers launched by New York state's attorney-general, Eliot Spitzer. For beyond all the scandals linked with the deflation of the bubble over the past two years lies a more fundamental point: that America's capital markets have done a pretty good job for the economy, and that the country's equity culture needs to be revived, not tossed out of the window.

It is instructive to compare today's bleak mood among investors with that after 1929. The economic outlook today is, of course, brighter, even if it is not without risks. But now, as then, the bursting of the stockmarket bubble has left many victims in search of somebody to blame. Now, as then, politicians and lawyers have been swift to demand retribution and reform. And now, as then, there have been demands for tough new regulation of the markets. In the early 1930s, these led to the establishment of the SEC, itself a crucially important factor in restoring public confidence in the markets. But it also led to several regulatory changes for the worse, among them the Glass-Steagall and McFadden acts, which weakened American banks for several decades without making either them or the markets significantly safer in the long run.

There is a risk of a similar regulatory overreaction today. The cure for most excesses of the stockmarket bubble lie in its very bursting, although those who may have broken laws should be pursued and prosecuted. Investors have learnt that shares go down as well as up; that investment bankers have a vested interest in selling stocks; that company bosses can manipulate accounts to suit their own pockets rather than their shareholders'; and that capitalism means that companies can and do go bust. Provided they heed these lessons, they are less likely to be so easily burnt next time round—and there is sure to be a next time.

The biggest mistake would be to sacrifice the benefits of well-functioning capital markets. All the evidence is that deep and liquid capital markets constitute one of America's biggest competitive advantages. Allocation of capital through markets is quicker, cheaper and more efficient, if sometimes more brutal, than it is when done by banks. This is not to deny that the markets may have further to fall, even after the past two years. But in the longer term, equity investment ought, for example, to be part of the solution to the rich world's pension crunch. In this respect, America has an edge over such places as continental Europe that remain weighed down by unfunded pension obligations. It would be highly damaging if discussions about the part-privatisation of America's Social Security, say, were derailed by loss of faith in Wall Street. It is time to praise the equity culture, not to bury it under laws and lawsuits.

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France's general election

Give the right sort of right a chance

Jun 6th 2002
From The Economist print edition

France needs a centre-right government—but with more guile and guts than before

Reuters

Get article background

NAPOLEON, writes one of France's leading commentators, would have voted for Jacques Chirac in the presidential election he won last month—on the ground that only generals endowed with that greatest of qualities, namely luck, should be given command. Mr Chirac, usually charming, sometimes shrewd but too often opportunistic and shallow, is certainly one of France's luckiest politicians of recent times. It was, after all, thanks to the stunning feat of the far-right's odious Jean-Marie Le Pen in coming second in the presidential contest's first round, so knocking out the left's main candidate, that Mr Chirac waltzed back so breezily into the Elysée in round two. In any event, now he has another chance, undeserved as it is, to push France in the right direction, provided that his luck endures and that, in the two-round general election on June 9th and 16th, voters give him a parliament, and thus a government, to his liking. Better for France if they do.

Not that the outgone Socialist-led government of luckless, charmless Lionel Jospin ruled badly. Despite its leftish verbiage, it nudged France further towards an open market and helped France grow faster than all of Europe's biggest economies. That growth reduced unemployment by a quarter, though it is still too high at 9% of the labour force. It trimmed taxes a bit. It sold off more state assets than did the previous right-wing administration. Public services, especially hospitals and transport, remain among the best in the world. France is still, in many respects, a success. So why choose another lot of politicians, of a different ideological hue, to fix a machine that isn't broken?

The first reason is that since the Socialists failed to win the presidency they have been tacking back leftwards in the hope of re-embracing the quarter of France's voters who, astonishingly enough, voted for more-left-wing presidential candidates. They have been promising to stop privatisation, for example. They have fallen into a mess of contradictions. They have no real leader and no sense of direction.

A second reason is that the latest five-year bout of “cohabitation”, whereby a president of one colour has shared power with a prime minister of another, has muddied political discourse and paralysed much decision-making. General de Gaulle's constitution of 1958, which set up the current Fifth Republic, presumes a strong president who can persuade voters to elect a parliament to his taste. The presumption no longer holds. France's voters may yet, in the impending polls, express a wish for power to be divided. That would not, at any rate in the next few years, produce good government, with parliament jibbing against further reform. France now needs a president and a parliament pointing in the same direction.

Finally, the mainstream right is now, after years of division, more cohesive than the left. Its legislative recipe makes broad good sense. Its caretaker prime minister, Jean-Pierre Raffarin, looks canny and persuasive. He should stay in the job, if the voters give the mainstream right a chance.

Where's the boeuf?

It is still uncertain, however, whether Mr Chirac and a would-be government of the right have the courage and clarity to promote the reforms France sorely needs—of its soon-unaffordable pensions system (see article), its extravagant health care, its over-regulated labour market. It should certainly

adjust the 35-hour week brought in by the Socialists, by excluding small companies from the scheme and preventing public services from becoming even more expensive than they are already. It should, anyway, cut the size of the civil service and sever its link with politics.

One problem is that, egged on by a romantic tradition that has lingered long after its revolutionary creators and their discredited credos have been buried, the French habitually protest against painful social reforms by making mayhem on the streets (see article). President Chirac's last reforming government of the centre-right fell, in 1997, soon after the mob had made a monkey of it in just that way. This time Mr Raffarin, if the voters and the president decide to give him his head, will have to be persuasive but courageous in equal measure.

Where does this leave Mr Le Pen? To Mr Chirac's credit, he has not pandered to voters' xenophobic feelings in order to win votes for the mainstream right that might otherwise go to extremists. But it will require still more courage, after the election, for Mr Chirac to tell his compatriots that banning immigration and blaming immigrants is not the way to stem France's rising tide of crime. Instead, much more strenuous efforts should be made to absorb them, economically needed as they are, into the fabric of society.

In any event, stirring up hostility to immigrants was by no means the only reason for Mr Le Pen's success. The political elites of left and right had come to seem aloof, corrupt—and indistinguishable on a range of issues. Mr Chirac has a chance to make amends if he can appoint a non-cohabiting government with a clearer sense of direction.

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South Korea

Family trouble

Jun 6th 2002
From The Economist print edition

Korean presidencies always end in disgrace. It would be better to end them with elections

AP

TWO of the country's favourite sports are currently entrancing South Koreans. One involves a round ball, and this week had Koreans cheering when their side beat Poland. The other also involves a good kicking, but is a rather less cheering sight: it is the game of discrediting the country's outgoing president at the end of his five-year term of office. This week President Kim Dae Jung's youngest son was indicted on charges of tax evasion and influence-peddling. Another son is also under investigation. President Kim's reputation, so high when this heroic former dissident was elected in 1997, looks likely to be in tatters by the time he leaves office next February. Still, at least he is in good company. All previous South Korean presidencies have also ended in failure.

President Kim's predecessor, Kim Young Sam, the country's first ever civilian president, had family trouble too: that Mr Kim's youngest son ended up with a three-year jail sentence for corruption. Both of the two military presidents who preceded the Kims—of whom one, Chun Doo Hwan, seized power in a coup, following which the other, Roh Tae Woo, won a semi-democratic election—ended up in prison themselves. Mr Chun's predecessor, Park Chung Hee, was assassinated in 1979, albeit more than 18 years after he had taken power in a coup. And Syngman Rhee, the country's first president after independence from Japan in 1945, was forced into exile by a student revolt in 1960.

Clearly the Korean presidency's headquarters, the Blue House, is well named: anyone unlucky enough to become president is going to end up feeling blue. Much of the explanation for that lies in a turbulent history of military dictatorships and repression. More recently, though, since South Korea became a fully-fledged democracy in 1992, another thread connects together the disgrace of both the President Kims. It is the country's system of a one-term presidency.

Cash in quick

After a series of dictators, it was natural that South Korea's new constitution stipulated that presidents should serve just a single five-year term. But the effect of that rule is baleful. It means that once elected, a president has little further value to his fellow politicians since he cannot run for election again, and he lacks the discipline of a future vote. More damaging still, it seems, is the effect on the president's family and entourage. They have a limited chance to secure influence and then peddle it; with the clock ticking, they rush to grab the cash.

Two disgraced Kims, you might object, are not enough to make a trend. A constitutional amendment to allow presidents further terms would not guarantee either discipline or probity. But it would raise the chances of both. It would be best to start debating a change now before further presidents are disgraced—and along with them, the constitution itself.

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The war against terrorism

Rebuilding Afghanistan

Jun 6th 2002
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Next week's *loya jirga* is just the beginning

Get article background

EPA

SIX months after a blueprint for its political transition was drafted in Bonn, Afghanistan is about to take the next step on the road to peace. Next week a *loya jirga*—or grand council—will meet to decide who the next head of state will be, and what the next government will look like. Only a year ago, few would have predicted the demise of the Taliban and the end of 23 years of civil war. Are Afghans finally about to have a taste of stability and prosperity?

Many obstacles need to be overcome before they do. This *loya jirga* should not be misread as the clear-cut happy ending of a successful American military intervention. It is the tentative beginning of what is likely to be, if all goes well, a long period of political and economic reconstruction (see article).

The first hurdle is the need to rebalance the ethnic composition of the government. The interim administration concocted in Bonn reflected the military balance of power after the Taliban's demise. Although it was headed by Hamid Karzai, a Pushtun, key positions were handed over to Tajiks from the Panjshir valley, who formed the backbone of the Northern Alliance leadership. The arrangement was supposed to last for only six months. Pushtuns, who constitute the largest ethnic group in Afghanistan, are now expecting redress. This is unlikely to happen in one go, but the next government should at least take a step in the right direction. Bringing in the former king as head of state would go some way to appease the Pushtuns until elections are held in 18 months and, given his general popularity, help to foster some sense of unity.

A second hurdle is to establish order. The end of the war does not mean that peace has settled in. Large-scale fighting may be over for now, but Afghanistan's rugged terrain and porous borders make a clear-cut victory against the remnants of al-Qaeda and the Taliban almost impossible to achieve. Together with dissident figures, such as Gulbuddin Hekmatyar, a former prime minister violently opposed to any form of foreign intervention, they could still inflict serious damage. In addition, local warlords are fighting over turf. This may only be the last hiccup before everybody settles into a new order. Or it may not. In the early 1990s, following the withdrawal of Soviet troops, rivalries among the *mujahideen* plunged the country into chaos and fuelled the rise of the Taliban.

To prevent this from happening again, the outside world needs to remain involved. The International Security and Assistance Force (ISAF) has gone a long way to secure the streets of Kabul and restore confidence, but its mandate is limited to the immediate surroundings of the capital. In spite of repeated appeals from members of the interim administration, foreign countries have refused to expand ISAF's reach. Instead, they are willing to help with the creation of a national army and police force. But this approach will take longer. At present, most of the country's armed men are under the authority of local commanders. Some may be won over by the prospect of government positions. As for the others, the best that can be hoped for is that the presence of American forces—and their commitment not to let Afghanistan descend into anarchy again—will provide enough of a deterrent, if not to prevent clashes, at least to ensure they do not spiral out of control.

Along with foreign muscle, the new Afghan government needs foreign money. There can be no lasting security without some hope of prosperity, and after nearly a quarter-century of war Afghanistan needs a lot of help. So far, most of the $1.8 billion given by donors for this year has been for short-term

humanitarian operations. Aid is needed to rebuild infrastructure, create a welcoming environment for private investment and generate jobs for the millions of unemployed. Some of this help should begin to arrive over the next few months. But international support needs to be sustained over years, long after Afghanistan fades from the limelight. To put Afghanistan back together, outsiders need to show staying-power.

And tact. Afghanistan's history teaches that foreigners should tread carefully. The best they can do is to help Afghanistan find its own path to political reconciliation, making sure it does not trip on the way. Solutions imposed by outsiders do not go down well anywhere, but trying this in Afghanistan could be a deadly mistake. Hospitable to well-behaved guests, Afghans are ruthless towards overpowering foreigners. Even well-meaning outsiders cross this fine line at their peril.

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Chechnya

Tell it like it is

Jun 6th 2002
From The Economist print edition

The West should speak out plainly against Russia's atrocious behaviour in Chechnya

WHEN Colin Powell, the American secretary of state, was summing up the latest spectacular breakthrough in relations between Russia and its cold-war enemies, he carefully made two points about the war in Chechnya. The first was that Russia was undoubtedly “fighting terrorists” in that republic. The second was that Russian troops must “meet the highest standards of human rights that one would expect from a civilised country.”

His first assertion may be formally correct, in the sense that some of the Chechens fighting to secede from Russia have used terrorist methods—although the identity of the perpetrators of the worst acts of terror against Russian civilians remains a mystery. It is also true that some Chechen warriors, perhaps only a minority, have sinister links with the wider world of Islamist terror. But Mr Powell's second point must sound like a sick joke to the inhabitants of places like Mesker-Yurt, a Chechen village where a longer-than-usual “cleansing operation” by Russian forces was going on as he spoke.

Human-rights organisations have put together well-documented, and consistent, accounts of what has really happened on all recent occasions when heavily-armed Russians surrounded, sealed and occupied Chechen settlements. Men have been taken away, almost at random, to be interrogated, beaten and in some cases killed and mutilated; women are threatened with rape unless their families can buy off their tormentors. If there are any hard-core Islamists in the vicinity, they can often use their money and connections to escape the Russian attackers; as in so many guerrilla wars, it is the hapless civilians who bear the brunt. And every time such “cleansing” takes place, the bitterness felt by most Chechens towards all forms of Russian authority only deepens. In recent days, reports of fresh atrocities have emerged from Mesker-Yurt; and given that Russia's commanders have consistently broken promises to restrain their men, there is reason to fear the worst.

If there is one glimmer of good news from Chechnya, it lies in the fact that even the Russian-backed local administration, run by relatively “loyal” Chechens, acknowledges freely that the army has behaved appallingly, sabotaging any moves by the Kremlin to prevail by consensus rather than brute force. The more sophisticated of President Vladimir Putin's advisers seem now to accept the need for most of the Russian troops in Chechnya to be withdrawn, leaving local police officers to take more responsibility for security in the republic. But there are strong signs that Russian commanders from the defence and interior ministries are undermining that proposal; and there is a nasty suspicion that their motives are financial. War in the Caucasus provides ample opportunity for greedy soldiers to make money through oil and drug deals, as well as extortion from local people desperate to pay ransom to secure the freedom of loved ones.

Westerners, including those who warmly welcome the recent improvement in Russian-American relations, would lose nothing—and gain a good deal of moral authority—by speaking out more bluntly about the counter-productive thuggishness of the Russian military's tactics. Three years of war have left Chechnya miserable and exhausted; that exhaustion could still lay the basis for a settlement in which Chechens set aside their bid for secession—while reserving the right to dream long-term dreams—and win relief from harassment.

Mr Powell's call for “civilised standards” to be observed in Chechnya was perhaps a good, if utopian-sounding, start. But, to borrow a favourite phrase from his predecessor, Madeleine Albright, he should not hesitate to “tell it like it is” if those standards continue to be so flagrantly violated.

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Letters

Jun 6th 2002
From The Economist print edition

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Getting round Britain

SIR – The suggestion that rail gets three times as much investment under the government's ten-year plan as roads gives a completely skewed view of the true picture ("What's wrong with roads", May 25th). Rail will get about £60 billion ($88 billion) of future public expenditure and private investment, and strategic roads a third of this sum. However, this compares apples with pears and throws in a few tangerines too. The road programme is for strategic roads only and excludes managed roads of local authorities. Rail funding includes all types of rail and a significant sum for rolling stock. The previous ten-year period shows strategic-road investment easily exceeding that for rail.

However, the figures obscure the essential conundrum. The present system of cost-benefit analysis always shows roads to have an advantage but often road schemes are unbuildable because of local opposition. Perhaps the model understates this cost. Overcoming it through, for example, the extensive use of tunnels would make roads far more costly. We should accept that rail and road are interdependent rather than play one off against the other. Both are suffering serious congestion that is likely to worsen and optimum solutions are needed.

Adrian Lyons
Director
Rail Forum

SIR – The answer to your question "What's wrong with roads?" is: nothing at all. But there is something wrong with attempting to drive without paying for it. A recent study for the Department of Transport, "Surface Transport Costs and Charges", found that revenues raised from roads amounted to only 36-50% of the marginal costs of road use, whereas revenues from passenger and freight-rail services respectively stood at just below and just above 100% of marginal costs. A recent study for the European Commission, "Revenues from Efficient Pricing", indicates that the efficient price for cars and trucks in Greater London would be almost three times higher in peak periods and twice as much in off-peak. Rail prices in Greater London were about right.

Rana Roy
London

SIR – Low-cost airlines are beginning to influence the transport market. A flight from London to Edinburgh costs about 5p per passenger kilometre against 9p by rail (before adding the costs of upgrading the line and additional safety features). Since 1996, more business passengers have chosen air over rail for journeys above 250 miles and the proportion of business travellers on trains has fallen from 9% to 4.5% for journeys exceeding 350 miles. "Indirect" low-cost airlines competing with Eurostar from London to destinations beyond Paris have forced down leisure fares and passenger numbers on the train service. It is said that the requirement for America's Amtrak to become free of operating subsidy by early 2004 is largely the result of competition from low-cost airlines.

A.J. Lucking
London

Growing bananas

SIR – You describe accurately the labour-rights abuses suffered by child and adult banana workers in Ecuador, and banana-industry officials are correct in observing that eliminating hazardous child labour is not an easy task ("Banana skins", April 27th). However, industry officials are disingenuous to claim that most child labour in Ecuador occurs on family-owned farms. None of the child banana workers interviewed by Human Rights Watch worked on a family-owned farm. Rather, they worked on larger commercial plantations that are clients of multinationals and powerful Ecuadorian firms. While the industry officials are correct that 70% of Ecuador's banana plantations are small, they omit the crucial detail that those small farms account for less than a quarter of Ecuador's total banana production.

The minister of labour accurately stated that impoverished children should have alternatives to work, but the ministry also needs to enforce child-labour laws. The director of labour inspectors for the coast, where banana production is concentrated, has a staff of only 13 inspectors for the entire region. The ministry has not even conducted a survey to determine accurately the number of child banana workers. It will be difficult to solve this problem if the government does not even know its scope and does not provide adequate resources to enforce existing standards.

Carol Pier
Human Rights Watch
Washington, DC

Gender politics

SIR – In French it is correct to use the masculine gender, *le ministre*, rather than the feminine, *la ministre* ("The mystery of language and ideology", May 25th). The sexism of French society, reinforced by the language, is all that allows purists such as Maurice Druon of the French Academy to insist that *ministre* can only be masculine. Take the word *directeur*. When a woman is the headmistress of a school, she is a *madame la directrice*, yet if she were the CEO of a company, she would be *madame le directeur*. Both forms are equally "correct"; it is only the status of the position that defines which is used.

Marc Naimark
Paris

SIR – Had Michèle Alliot-Marie joined the armed forces (rather than being appointed minister of defence) there would be no confusion between sex and gender: she would have been *une recrue*. Should Jacques Chirac not gain a majority in the French Assembly in the forthcoming elections, Mrs Alliot-Marie will no doubt be *une victime*; again no confusion. However, *la personne* who replaces her will not necessarily be a woman.

Thomas Wight
Edinburgh

Prodi's Napoleon complex

SIR – You describe Romano Prodi's plans for Europe's future as "Napoleonic" (Charlemagne, May 23rd). The reference is well chosen. Reflecting on his faded glory in exile on St Helena, Napoleon wrote about his wish to see but one people in Europe founded on "a European system, a European code of laws, a European judiciary." Mr Prodi would be well advised to ponder why Napoleon failed. Leaving aside military matters, the answer is that he tried to push too hard at a time when his luck had run out. One wonders whether Mr Prodi's sense of timing is any better. Does anyone support the idea of a strong European Commission and an ever closer union at the moment?

Risto Penttila
Helsinki

Grave misattribution

SIR – Joseph Bonanno (Obituary, May 18th) may well have benefited from the "double coffin" system to remove unwelcome competition but he did not invent it. Sir Arthur Conan Doyle had Sherlock Holmes rescue Lady Frances Carfax from a double coffin in which she had been incarcerated by the evil Holy Peters in "His Last Bow", published in 1917. Sir Arthur would no doubt turn in his (single) coffin were he to suspect that the exploits of his hero inspired similar skullduggery by the *capo di tutti i capi*.

Richard Hooper
Nairobi

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Afghanistan

So much done, so far to go

Jun 6th 2002 | GARDEZ, JALALABAD AND KABUL
From The Economist print edition

EPA

As the loya jirga meets to plan Afghanistan's future, the country is still too fragile for comfort

Get article background

BUSINESS has not been good at the Rokhsar beauty parlour lately. While sorting her wooden curlers and looking at her dwindling stock of shampoo, Karima Wahidi, who has been running the business for ten years, is lamenting that she can barely make ends meet.

Since the Taliban left Kabul, she does not have to operate undercover at least, although the women who push at her door are still hidden under their *burkas*. Nadima Ahmadzai, a high-school teacher, says she started wearing hers even before the Taliban took over Kabul. She does not want to face men's stares. Even Mrs Wahidi carefully removes her make-up before going home. Self-indulgence has not yet made it to Afghanistan, and most of her customers come for special occasions only. But the brides-to-be in *burkas* have been scarcer recently. The main problem, says Mrs Wahidi, is that people have put off their wedding plans. They are waiting for the *loya jirga*, or grand council, which will be held from June 10th-16th, and which will shape their country's future.

Loya jirgas, which bring tribal, religious and local leaders together, have traditionally been the way for Afghan rulers to take the country's pulse. According to plans drawn up in Bonn last December, the 1,501 delegates to this particular *loya jirga* will designate the head of state and the next government, which will succeed the current interim authority headed by Hamid Karzai. In 18 months another grand council will be called to approve a new constitution, after which there will be elections.

The *loya jirga* commission, set up in January, has reserved about one-third of the seats for specific groups such as women, religious figures and nomads. The remaining two-thirds have been allocated to the country's districts on the basis of population, with delegates chosen by local councils in consultation with the people. This has not been easy. The exact number of districts is still being contested, and millions of people have been displaced by war.

Personal rivalries, bad-mouthing and bickering are an intrinsic part of the *loya-jirga* process, and always have been. A flood of complaints has come from areas claiming to be separate districts or demanding more seats—especially from Pushtuns, traditionally the leading tribal group in Afghanistan, who feel that their true weight in the national population has been underestimated. But intimidation and violence, which are not normal, have also marred the consultation. Eight candidates have been murdered; in Herat, delegates were imprisoned. Hundreds of people have reported bribery and intimidation, or have complained that some delegates, supposed to be of good moral standing, are in fact criminals, bullies or members of al-Qaeda.

At the Jalalabad regional centre, the tiny mailbox collecting complaints—most of them scribbled on scrap paper—is overflowing, while dozens of villagers wait outside the gates to make their cases to the three overworked staff. Recently, villagers from the same district descended upon the commission's office to protest against one delegate; some brought court files, a rare commodity in Afghanistan, to support their allegations. In the Muhmand Dara district of Nangarhar province, over 10,000 people, armed to the teeth, turned up to select their delegates; the local commission decided to send them home.

In spite of the difficulties, the population's determination not to have the *loya jirga* stolen from them has sometimes defeated intimidation and bribes. In Daychopan, in Zabul province, the local warlord's candidates were publicly accused of being murderers and kicked out of the consultation. In Jalalabad, to minimise risks of intimidation, delegates have been kept in town before going on to Kabul for the gathering itself. Over the past few weeks, tribal leaders have been meeting in the capital to sort out their differences and endeavour to create a united front.

A delicate tribal balance

Expectations for the *loya jirga* are high—unrealistically so, of course, since its task will not be easy. Future stability will depend, in part, on whether the next government more closely reflects the country's ethnic make-up. The six-month interim administration has been heavily tilted in favour of Tajiks from the Panjshir Valley, a small proportion of the country's population but the backbone of the Northern Alliance forces who helped rout the Taliban regime. Tajiks control the key ministries of defence, interior and foreign affairs. Seats in the next government will not only be allocated to achieve a different ethnic balance, but may also be used to buy allegiance from local commanders, such as Ismail Khan in Herat, who have so far thumbed their noses at central authority.

Mr Karzai's job as head of government seems secure, at least. An unusually dashing figure on the world stage, he enjoys the support of the former king, Zahir Shah, the international community and, according to the foreign ministry, the country's main power-brokers. But some Pushtuns grumble at his perceived inability to defend their interests, especially after the murder in broad daylight of Abdul Rahman, the civil-aviation and tourism minister, in February. “He's done a great job with the outside world,” says a Pushtun from Balkh, “but he's been a disappointment at home. He's just a loudspeaker for the Tajiks.” Others describe him as an “unknown celebrity”, a compromise figure who suddenly emerged from relative obscurity after the meeting in Bonn.

Some debate also concerns the future of Zahir Shah, 87 years old and only recently returned from 29 years of exile in Rome, and the nature of the role he will play. Endless throngs of village and tribal delegations from all over the country come daily to his leafy residence in Kabul to pay their respects. Sitting in his living room, looking out at the crowd waiting for him in the garden, the former king complains that he's been tired lately, but hopes that he can get more mileage out of his body for the national tour he plans to make in the next few weeks.

He may be frail, but his mind is sharp, and his French still impeccable. He says he has no interest in reviving the monarchy, but is ready to fulfil any role the *loya jirga* may bestow upon him, including head of state. Not everyone is thrilled with that prospect, including several prominent figures in the former Northern Alliance, who would rather not have another Pushtun, as well as Mr Karzai, at the head of things. But given the former king's broad popularity, his endorsement of the next government could help strengthen central authority beyond the confines of Kabul.

Check your gun at the door

Even if a reasonably acceptable government comes out of the *loya jirga*, stability and prosperity are still a long way off. Security, too, is still a rare luxury in Afghanistan. The International Security Assistance Force (ISAF) is restricted to Kabul only. Its installations have been targeted by rockets, and there are fears that the *loya jirga* itself could be the target of terrorist attacks. Coalition forces, with the help of locally recruited militias, are still hunting for elusive remnants of the Taliban and al-Qaeda in the eastern part of the country, along the porous border with Pakistan.

Rival local commanders around the country have also been fighting for turf. Near Mazar-i-Sharif, Mohammed Atta, a Tajik commander supported by Mohammed Fahim, the defence minister, has been challenging Abdul Rashid Dostum, Mr Fahim's Uzbek deputy. There has been fighting over the governorship in Gardez and at least three other provinces. People in Jalalabad started enjoying peace only a month ago, when one of the contenders for power packed his bags and crossed the mountain to Pakistan. In a nearby village, elders sipping tea on a Friday afternoon reflect that these local commanders are just as bad as al-Qaeda.

The interim administration has had neither the muscle nor the authority to prevent factional fighting, and the outside world has not helped much. Life in Kabul has improved, but the city is hardly representative. ISAF has secured the streets of the capital, and the cruising khaki cars and tanks give people welcome reassurance. Shops have reopened, an army of yellow taxis jams up the already congested traffic, and English dictionaries lie alongside the Koran in the city's bookshops. ISAF's mandate, however, does not extend beyond the immediate surroundings of the capital. Despite repeated calls from members of the interim administration, foreign governments have shied away from providing the troops or money necessary to beef up the force and deploy it to other cities.

The sheer number of weapons circulating in Afghanistan compounds the problem. In banks in Kabul visitors check in not bags but guns, which they pick up from the collection desk on their way out. Farmers have been known to plant landmines around their fields to discourage potential trespassers. By the side of the road outside Kabul, a man has set up rocket-propelled grenades around his pile of scrap wood in case anyone is tempted to snatch it. Banditry and extortion are flourishing along the country's main roads.

Even where there is no fighting, the central government's authority is often contested. The governor of Herat, Ismail Khan, has been running his province with a free hand. Customs duties for goods coming from Iran never make it to Kabul. Humanitarian agencies which have been helping Afghan refugees returning from Iran report that the local truck-driver cartel has ramped up transport prices by 17-20 times, disrupting the programme. In some areas, local commanders are believed to derive generous profits from the banned opium trade.

One country, just about

On the bright side, no one seems to be seriously thinking that Afghanistan should be broken up into autonomous pieces. Afghans have no great love for central authority, but breaking ranks to join neighbouring countries does not seem to be considered an alternative. Even the idea of a loose federation enjoys only limited support. A reasonable degree of decentralisation, however, is unavoidable in a country as fragmented as Afghanistan. Deciding the best balance between central and local authority will be one of the main tasks of the constitution that is to be drafted over the next 18 months.

Short of providing troops to help secure the country and beef up central authority, the outside world is betting on carefully applied pressure on the most unruly local elements, as well as the revival of a credible national army and police. An estimated 75,000 soldiers and another 100,000 militiamen are working for local commanders, often the best or only employers around. Formal disarmament is not in prospect, as local commanders are not ready to hand in their weapons. The idea is to demobilise by gradual reintegration. Those men who make the grade will be hired for the national army or police, which should eventually be 80,000 and 70,000 strong respectively.

Others, it is hoped, will choose civilian life as more jobs become available. The case of Mirshah, who fought with the *mujahideen* against the Russians and then the Taliban, could become typical. When he came back to the Shomali plain round Bagram after two years in Pakistan, Mirshah went straight to his ex-commander, who recruited him for his security forces. But he soon tired of daily marching exercises and pay of $2 a month and, when offered a chance to work as a builder for $2 a day, he walked out. The job will last for only a few weeks, but Mirshah is confident that others will come his way.

The interim administration, advised by Germany on police matters and the United States on the military side, has drawn up organisational, recruitment and training plans for a national army and police. These are supposed to reflect the country's ethnic composition, and training is set to span the next 18 months, one battalion at a time. The government estimates that maintaining the armed forces alone will cost about $135m a year. Foreign donors will have to foot the bill for most of it, and have proved reluctant so far.

There is no certainty, either, that these new forces will be loyal to the central government. The two battalions now being trained by the Americans and the French are being paid with foreign money, but most armed forces in the country are on the payrolls of local commanders. Six months ago, the UN development programme set up a temporary trust fund to ensure that civil servants—including the police—would be paid. The lucky ones have been receiving $30 a month, which, even in Afghanistan, does not go far. But reconstructing accurate payrolls has been difficult, and at the police station across the street from the German advisers' office no one got paid last month.

Street-cleaning or poppy-growing?

Ex-combatants are not the only ones needing jobs. Years of war have left Afghanistan one of the poorest countries in the world. Over the past few months, close to 1m refugees have returned from Pakistan and Iran. Every day, dozens of trucks loaded with families converge on Kabul, the favourite destination. The country, however, is struggling to absorb newcomers in these numbers. Decent housing is too scarce, and jobs too few.

Job-intensive reconstruction projects, from road building to irrigation repair, have not yet started, since money for longer-term development programmes has been slower to appear than humanitarian assistance. To fill the gap, the UN development programme has launched a $3m initiative to create short-term jobs, such as cleaning up streets or planting trees. This has so far focused on Kabul, but will be expanded to Kandahar and Jalalabad. For Rezai, a Hazara farmer from central Afghanistan, clearing the rubble of Kabul's devastated southern suburbs is the only job he has had in a year. Prolonged drought pushed him to leave his native province a year ago to try his luck in Kabul. Once in the capital, however, he could not find a job. To feed his eight children, he put the two eldest to work making carpets and borrowed money from relatives.

In rural areas, the situation is dire. The rains have been better this year, but the country is unlikely to produce enough food to feed its people. The UN's World Food Programme and the Food and Agriculture Organisation are currently trying to estimate how much food assistance will be needed this year. In some areas, despite a government ban, farmers have turned back to the lucrative business of growing poppies for opium, an activity eradicated by the Taliban. In Khogyani, in Nangarhar province, Juma Gol, a local farmer, explains that cultivating poppies is the only way he can feed his ten children. This year, he sold 40 kilos for almost $15,000. His neighbour has not been as lucky. To make ends meet, he sold his 12-year-old-daughter for $1,000.

In the neighbouring village, Said Mulhaq, a shopkeeper who keeps bags of opium on his shelves behind the tins of tomatoes, says this year has been good. He sold all 500kg of the opium he bought from farmers to Pakistanis, who come from across the nearby border, with a 40% mark-up. With a Kalashnikov against the wall and a pistol under his arm, he is not going to let the government stop him. When the authorities showed up to destroy their crops, more than 10,000 people blockaded the area. They all maintain they would rather plant something else, but as long as the village does not get help for a school, a health clinic and electric power, they see few other options. The government claims that one-third of this year's crop—the equivalent of 76 tonnes of heroin—has been eradicated: good work, but it still leaves a fair amount behind.

Foreign donors have promised $4.5 billion in aid over the next five years, $1.8 billion of which should be given this year. Picking up the pieces after 23 years of war will be slow and painful, but the interim administration is at least firmly in the driving seat. An Afghan Assistance Co-ordination Authority has been created to deal with the 61 donor countries and dozens of NGOs providing assistance, and to make sure their help fits in with the government's priorities. The private sector is expected to be the driving force for reconstruction. A foreign-investment law has been drafted, the defunct banking system is being revived and the tax system—which features a 60% levy on property revenues, but no income tax—is being rethought. Investors, however, will want to see more basic improvements—security, a decent infrastructure and a check on corruption—before committing their money to the country.

The next transitional government, whatever it turns out to be, is likely to face a tough 18 months trying to secure and rebuild the country. This is the best chance Afghanistan has had in several decades, and, with the help of the outside world, the country could at last be looking at a brighter future. If all goes well, people may even start getting married again, which should be good news for Mrs Wahidi and her beauty parlour.

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The political scene

Here they go again

Jun 6th 2002 | WASHINGTON, DC
From The Economist print edition

AP

Politics is getting back to its normal pre-September 11th pattern. Sort of

THREE scenes from June 4th. In the Capitol, the House and Senate intelligence committees begin secret hearings on the September 11th intelligence failings, the first real legislative scrutiny of this part of the administration's war on terror (and something the vice-president, Dick Cheney, had previously implied was unpatriotic). Elsewhere in the Capitol, White House officials grudgingly hand over more documents in the Enron case. And in seven states voters cast their ballots in primaries to choose candidates for the November mid-term elections, the first crowded day of this year's voting season.

To round out the picture, the president recently completed a round of money-raising for his party (pulling in a record $30m in a single night) and the two parties unveiled their main ideas for the session of Congress that began this week. Republicans want to make Mr Bush's tax cuts permanent (in theory, they lapse in 2010); Democrats want new hate-crimes legislation. Politically, this is the old-time religion: ideas designed to gladden the hearts of the parties' core supporters.

In the weeks after September 11th, some politicians wondered if the response to the attacks might fundamentally alter American domestic politics. Partisanship, they thought, would be limited; trust in government would be restored; national security would establish itself at the heart of political debate, probably to the Republicans' benefit. Even now, according to one poll, 75% of respondents say the attacks will change politics forever. Has it happened? Like hell it has.

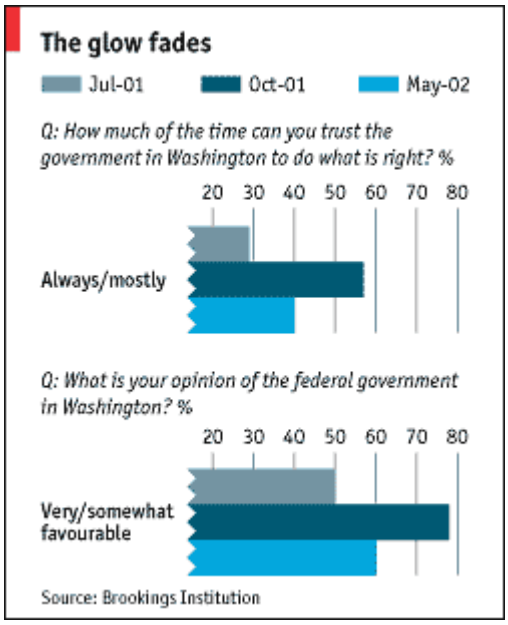
Consider the advice the two parties are getting from their strategists. Last month, John Podesta, a former chief-of-staff to Bill Clinton, brought together congressmen and women with party bureaucrats to work out how Democrats should fight this year's election. The group settled on five issues. Backing the war on terror was not one of them. Rather, it was the mixture as before: opposing plans to privatise Social Security; more money for education; subsidising drug prescriptions for retired people under Medicare; tougher environmental legislation. The only new thing is a promise to “provide real pension protection”—ie, not to let the likes of Enron bilk the pension-fund holders again.

In some ways, the programme is less adventurous than anything Mr Clinton espoused, since it ignores his favourite themes of reforming government and boosting economic growth. It is the party's 20-year-old lowest common denominator. So much for the idea that September 11th would create a new politics.

Could it be that Democrats have no choice, since they cannot pretend to have anything more than a best-supporting-actor role in the war against terror? Perhaps. But consider the advice Republicans have been getting. Bill McInturff of Public Opinion Strategies recently asked people, “Which is more important to you in deciding how to vote for Congress, domestic issues (like taxes, health care and education) or international ones (like terrorism and the Middle East)?” The answer was overwhelming: 79% said

domestic issues, even though, when asked what Congress's top priorities should be, people put terrorism and national security first. Curiously, then, national security does remain important—except when it comes to voting intentions.

Mr McInturff's advice to Republican candidates is clear. Don't rely on the war on terror to guarantee victory, as Karl Rove, the president's chief domestic adviser, suggested only in January. Don't rely on Mr Bush's personal standing, high though that is. Don't rely on tax cuts. “American memories last a nano-second. We are moving beyond a world shaped by September 11th. You have to address issues of concern here at home.” In other words, the same pocketbook issues that Democrats want to run on.



Mid-term elections are traditionally about motivating your most loyal backers, since they are the ones likely to show up on polling day. The coming elections may therefore exaggerate the return to political normality. But it is happening anyway.

One of the striking features of post-September 11th America was the surge in trust in public institutions, notably in the federal government. After declining for decades, this suddenly soared to levels last seen in the 1960s. The rise was just a spike. According to the Brookings Institution, trust in the federal government has plummeted from its peak of 57% in October to 40% now, higher than it was last July, but a big fall nonetheless.

According to Gallup, approval ratings for Congress fell further, from 85% at the peak to 54% now. And Mr McInturff has found an extraordinary reversal in the post-terror view that religion is increasing its role in public life. Last December, 71% of respondents said its role was increasing and 24% said it was falling. Now, 52% say religion is losing influence; only 37% think it is still gaining. There seems little left of the “new” post-September America.

Whether Mr Bush's own performance reflects or contributes to the reassertion of normality is unclear. What is certain is that he has not taken the opportunity to recast the political mould, as some argued he could have done.

Ron Brownstein, a columnist for the *Los Angeles Times*, argues that the president's policies fall into three categories. The headline-grabbing bits please his conservative supporters (defence spending, tax cuts, judicial nominations). In a few selected areas, he has broken with conservative orthodoxy to appeal to particular interest groups who might vote Republican next time (steel workers have been pleased by tariffs, farmers by more farm spending). Only in a few areas has he tried something really new that might attract both conservatives and moderates, such as his education reform or the still-wobbly “faith-based initiative” to boost the public role of religious charities. This is the record of a man seeking re-election by the tried and trusted formula of securing the base and then adding a few targeted groups, not of someone trying to lay the foundations for wider political change.

It is fair to say that Mr Bush's own standing is the exception to the overall picture of reverting to the mean. Though his ratings have slipped by a point or two every month this year, the president is still extraordinarily popular by most standards. This is attributable, at least partly, to what Marshall Wittmann of the Hudson Institute calls “the national post-September stress syndrome”. Every time some new FBI bungle is revealed, or an official issues another terrorist warning, it is a reminder that things are not quite as they were. They are only almost normal.

What does that mean in practical terms? Domestically, that the race for Congress is even again (and Congress, remember, is almost equally split between the parties, with control of the Senate in particular hanging on the loss or gain of a single seat). Democrats think that, were it not for anxiety about national security, they would run away with the mid-term elections, since “their” issues are coming to the fore. As it is, they have wiped out the six-point polling deficit they faced in January, and are now a point or two ahead—but no more. All is still to play for.

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The Iowa Senate race

On Harkin's trail

Jun 6th 2002 | IOWA CITY
From The Economist print edition

A Senate seat the Republicans may just catch

WARMED by the upcoming Senate campaign, Iowa's political spring came early this year. The TV attack commercials began in February. President George Bush appeared at a Cedar Rapids fund-raiser in April. Now that Tuesday's Republican primary is done, most forecasters expect a long hot autumn.

The primary ensured that Greg Ganske, a doctor and fourth-term Republican congressman, will take on Tom Harkin for one of the more vulnerable Democratic seats in the Senate. Mr Harkin, 62, is a third-term Democrat who sails as far to the left as a Democrat can these days; he is best known for the Americans with Disabilities Act, a bill of rights for the physically impaired which, though well intentioned, has proved a headache to employers and developers everywhere. Dr Ganske, who came in on the Newt Gingrich revolutionary wave in 1994, is less easy to pigeonhole politically. He has voted with Democrats on patients' rights, federalising airport security and campaign-finance reform. He beat—less easily than expected—Bill Salier, the sort of pro-gun, pro-life, pro-business ex-Marine so beloved of conservatives.

The immediate object is Mr Harkin's seat. But the larger prize, as in similarly tight races in neighbouring Minnesota, Missouri and South Dakota, is control of the Senate, where Democrats now cling to a 50-49 majority. First-quarter figures for spending by political action committees showed Mr Harkin and Dr Ganske as their parties' third- and 12th-biggest beneficiaries respectively.

Mr Harkin's chairmanship of the Senate Agriculture Committee will help him greatly in a state with so many farms and retired farmers. The recent federal farm bill will bring Iowa plenty of money. Some 68,000 of 91,000 Iowa farms—75%, the highest percentage in the country—stand to benefit directly, and Mr Harkin estimates that support payments on the average thousand-acre farm will increase next year from $74,000 to $84,000. Though Mr Bush signed the bill deliberately to shore up his farm support, Mr Harkin has fervently claimed it as his own in Iowa, and should profit accordingly. Mr Ganske (alas for him) voted against it.

Polls last December already showed Mr Harkin leading Dr Ganske by 57% to 34%, and the latest figures for money-raising show him ahead by two to one, with over 60% of his campaign chest provided by business. But money isn't everything. According to Mr Harkin's campaign manager, any Republican candidate can expect 45% for merely showing up. Consider, too, that one of every nine voters lives in Polk County, which includes Des Moines, the state capital; and Polk County is where Dr Ganske upset Neal Smith, an 18-term House Democrat, in 1994.

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Health-care costs

Emergency as normal

Jun 6th 2002 | LOS ANGELES
From The Economist print edition

California leads, but the rest of America is not far behind

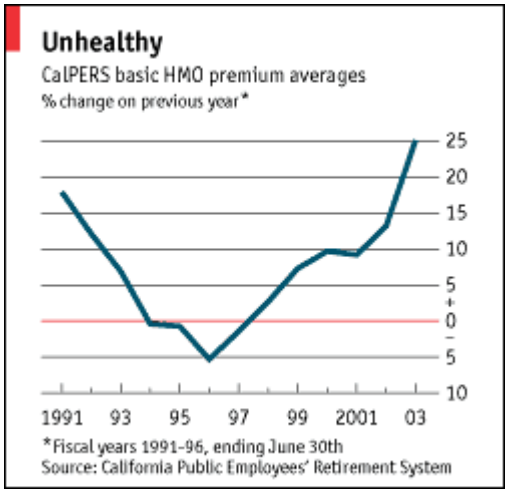
MID-AFTERNOON on a Monday, and eight hospital trolleys are parked around the receiving desk in the emergency room. Some occupants are bored, some unconscious. One of them, fresh from a car chase, is shackled by the ankle to his bed. A guard keeps an eye on both him and the shaven-headed man at the head of the queue. That fellow's loose green overalls make him look a little like one of the orderlies, until you notice the word “Jail” stencilled on the back and the handcuffs round his wrists.

The Los Angeles County-University of Southern California Medical Centre is one of the largest public hospitals in America. Each year it treats about 200,000 patients in its emergency room, and most of them do not have insurance to cover the cost of their treatment. The attention they get is first-rate. The rooms in the intensive-care units upstairs are packed with the electronics that are part of the arsenal of modern medicine, and the teaching link with the university ensures top medical expertise.

But maintaining that level of care is expensive. The county Department of Health Services, which serves 3m uninsured residents with a budget of $4.7 billion, will have a deficit of $850m by 2006, when a federal bail-out from an earlier crisis expires. On June 18th it will submit its latest plan to the county supervisors, with proposals to lay off at least 5,000 of its 22,000 employees and to close some smaller hospitals.

The state is also strapped for cash thanks to a crash in tax revenues. Its new budget plan proposes a cut of $1 billion in health care, $100m of it to come from Medi-Cal, the state's version of Medicaid, the system that pays for health care for the poorest Americans. Public hospitals are in a tough position. The cost-pressure they face is driven by the private sector, which sets standards of care and prices; but their requests for extra funding have to compete with other public services such as police and fire departments, which would soon squawk if hospitals got bigger increases than they did.

The cost of health care is rising sharply everywhere. The California Public Employees' Retirement System (CalPERS), the second-largest buyer of medical insurance in the country after the federal government, has just raised its premiums by an average of 25%, the largest jump ever in a single year (see chart). An equally large rise is likely next year.



Some causes of this inflation are unique to California—in particular, an expensive “seismic-refit” law requiring all the state's 400-plus hospitals to strengthen themselves against the risk of earthquakes. But most of the state's problems—from the rising number of uninsured to a shortage of nurses—occur all across America. California led the way in earlier rounds of health-care reform, embracing market-driven managed-care systems earlier and more fully than any other state, and it remains a bellwether. The only mitigating factor is a state law that limits legal settlements for “pain and suffering”, which can reach tens of millions in other states, to a mere $250,000.

What goes around

There are four main groups involved in health care. First, the patients. Most of these have their insurance

provided, usually as a job benefit, by the second group, the buyers—typically the firm that employs them or a group such as CalPERS. The coverage is supplied by the third group, the health plans, which collect premiums and pass on payments for patient care to the fourth group, the “providers”, meaning hospitals and doctors.

Inflation starts at the point of supply. New technology pushes up costs. Pharmaceuticals are expensive—33% of the money spent on drugs goes on the newest brands, although they account for just 17% of all prescriptions. Body-scanners cost $1m, whereas the X-ray machines they replace cost $100,000. Consumers demand new products—all the more so since the manufacturers increasingly advertise directly to them—and every other group tries to avoid being the one that bears the cost.

For a while, the purchasing groups were winning this battle by using their muscle to demand lower premiums. CalPERS, with 1.2m members, and the Pacific Business Group on Health, an alliance of 45 large employers that buys health benefits for 3m people, demanded, and for four years up to 1998 won, successive reductions in premiums. By 2000, premiums in California were 21% below the national average. Health plans passed the cutbacks along by consolidating into an oligopoly in which each plan had so many members that no provider could afford to refuse to do business on their terms. Six health plans now control 80% of the market in California.

This bargaining strength helped force the cost-cutting on to the providers. Most health plans in California adopted “capitation”, whereby they pay providers a fixed fee per visit for seeing their members, rather than a fee assessed on what service was provided and how long the visit took. The average capitation rate fell from $45 per patient per month in 1993 to $29 in 1999. Fees from the public side are equally tight: the latest Medi-Cal cuts will reduce the payment a doctor receives for seeing a patient from $20, which is already less than cost, to $16.

Absorbing these pay cuts has strained the providers. It has also been accompanied by ever-heavier administrative burdens, as health plans have demanded elaborate book-keeping and adherence to complex approval processes for new treatments, raising doctors' costs just as their income is falling. This cuts the efficiency of doctors and lowers their morale, as their authority is undercut and their patients sulk because they are not allowed expensive treatments.

Lately, however, groups of hospitals and doctors have banded together in search of oligopoly power of their own, linking so many providers under one banner that no plan can afford to pass it by. The consolidation in the provider market produces plenty of casualties. More than 20 such “independent practice associations” went bankrupt last year, and many are insolvent, while 23 hospitals have closed. But enough survive to have forced price rises back on to health plans.

All this competition has produced savings, but there is little fat left to squeeze. Two kinds of innovation offer a way out of the economically destructive “loop”. The first is administrative, by which new entrants to the health-management business would apply techniques that have boosted productivity in service industries. Peter Boland, a consultant, suggests that firms that understand how to tailor services to individual customers, such as financial-services businesses, could compete with health plans. The other innovation is medical, shifting the emphasis from responding to illness to pre-empting it. Some providers' groups, such as the Hill Physicians Group in the Bay Area, are starting to do this.

At the bottom of the financial scale, as more firms stop offering insurance, more people are left without coverage. Andrew Bindman, a doctor at San Francisco General Hospital, where a quarter of ward-time is taken up by homeless people, speculates that as the gap between the insured and the uninsured continues to widen, and as the number of those without coverage extends further into the middle class, it will become politically impossible to ignore. So far, however, the signs are not good. The greatest political effort on health care at the moment is aimed at the “patients' bill of rights” and prescription-drug benefits for old people, both ways to pamper people who are already well served. Nothing much is being done for the 40m Americans who, like the jail-birds on their trolleys in Los Angeles, have to take their chances in the emergency room.

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Intelligence failures

It gets worse

Jun 6th 2002 | WASHINGTON, DC
From The Economist print edition

Al-Qaeda meeting in Malaysia; don't pass it on

SOON after September 11th, a senior adviser to the Bush administration remarked that he would not be surprised to discover someone, somewhere had had a credible warning about the attacks. This seemed far-fetched. Not now. The CIA, it turns out, had detailed information about two of the hijackers more than 18 months before the attacks.

The story, revealed in the latest *Newsweek*, goes as follows. In January 2000, American monitoring of a mobile-telephone number in Yemen, which acted as a switchboard for al-Qaeda, discovered that the terrorist group was about to hold a meeting in Kuala Lumpur. The CIA asked Malaysia's secret services to monitor it. They duly reported back with names and photographs.

As a result, the CIA learned that one attendee, Khalid al-Mihdhar, already had a multiple-entry visa for the United States. And it tracked another, Nawaf al-Hazmi, as he flew from the meeting to Los Angeles. These two men later hijacked the airplane that crashed into the Pentagon on September 11th.

The agency says it told the FBI about al-Mihdhar. But it did not, it seems, say anything about al-Hazmi. And it said nothing about either to any other agency, such as the State Department or the Immigration and Naturalisation Service. Hence the two men were able to operate freely in America. Al-Mihdhar was even able to get his visa renewed by consular officials in Saudi Arabia who knew nothing against him. To top it off, the man at whose house the meeting occurred later got another interesting visitor: Zacarias Moussaoui, the “20th hijacker”. “We couldn't fathom it really,” Malaysia's justice minister told *Newsweek*. “There was no show of concern.”

Over to Washington, where, this week, the joint Senate and House intelligence committees at last began to investigate. Washington has been stunned by the revelations: shock is the respect fair-mindedness pays to such ineptitude. Beyond that, three lessons emerge.

First, co-ordination is still dismal. The CIA e-mailed the FBI about al-Mihdhar. It did not send out a formal, take-note-of-this alert. The FBI could not obtain more information because its database and the CIA's have not been integrated.

Second, the clash of cultures is a real problem. One reason the CIA did not share all its information is that it prefers to continue an investigation for as long as possible in the hope of digging out more. The FBI likes to bring an investigation to an end by charging someone. This may take years to overcome.

Third, it is not clear that the agencies took al-Qaeda seriously enough before September 11th. It is not just hindsight that says more attention should have been paid to the Kuala Lumpur meeting. Another man who was there was Tawfiq bin Attash. Nine months later, he probably took part in al-Qaeda's bombing of the *USS Cole*. The CIA found it already had a photograph of him—standing next to al-Mihdhar in Malaysia.

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Erring priests

A policy of sorts

Jun 6th 2002
From The Economist print edition

But still inadequate, as well as late

AP

The archbishop apologises

IN A year of sorrows for all Catholics in America, one of the saddest moments came last Friday. It was then, in the course of a prayer service in Milwaukee, that Archbishop Rembert Weakland offered a public apology for the actions that have led to his de facto resignation after 25 years of service. Archbishop Weakland was a giant of the church, an outspoken liberal who did not hesitate to promote women and condemn the excesses of the anti-abortion movement. But soon after his appointment he started a relationship with a male graduate student to whom, eventually, he paid $450,000 in an out-of-court settlement to keep the matter quiet. Although the case is being investigated, it seems that much of the money must have come from his archdiocese.

So the saga goes on, each week toppling some figure of assumed moral virtue and uncovering stomach-turning incidents from the past. To date more than 200 priests, out of just over 46,000 in the United States, have either resigned or been removed from their ministries since the revelations of sexual misconduct by clergy began in January. Archbishop Weakland's case, involving consenting adults, was untypically mild. Most of the other cases have been crimes, pure and simple, whose gravity was sometimes wilfully concealed by the expedient of shifting paedophile priests from one parish to another.

The laity, who feel they might never have learned of any of this if the media, and especially the *Boston Globe*, had not laboured to unearth it, now passionately want the hierarchy to put its house in order. This, above all, is what they expect from the next six-monthly meeting of the Conference of Catholic Bishops in Dallas on June 13th-15th. When the 12 American cardinals were summoned to Rome in May for an unprecedented “crisis audiience” with the pope, they postponed any policy decisions until then. Now the bishops will have to do something.

The proposals from their Ad Hoc Committee on Sexual Abuse, on which they will vote at the meeting, were announced to the press on June 4th. They go part-way towards what most American Catholics would like to see and would, if approved, be the first set of national rules binding bishops in such cases. In future, any priest who molests a young person will be removed from his ministry. So, too, will any priest who is found to have abused more than one child in the past. However, the committee did not insist that every past abuser should be removed. Each bishop, they said, should appoint a review board to evaluate priests who already have a single charge against them. This would mean, outrageously, that many such priests would stay in place.

“Zero tolerance”, which some bishops themselves want and which some already practise, was probably always too divisive to be enshrined in the new rules. But the committee boldly suggested another unpalatable step, which is that bishops should turn any new allegation of child sexual abuse over to police or district attorneys for investigation. Again, some are already doing so; but most members of the American hierarchy have long felt that offences committed by priests must be dealt with internally, almost as family matters.

To pass in Dallas, the proposals must be approved by two-thirds of the bishops. They are thought to be so keenly aware of their public shame, and the jeopardy of the church both moral and financial, that they will be only too eager to agree to them. But America's bishops, independent-minded though they seem at

times, are not, of course, free agents. They will still have to ask Rome's permission to make any policy mandatory and, though this is likely, it is not guaranteed.

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Schools and lawsuits

Please Miss, what's an IEP?

Jun 6th 2002 | NEW YORK
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Sit down, or I'll call my lawyer

WHEN an underground student newspaper appeared in high-school hallways last year, officials of the Los Angeles Unified School District were worried. When the paper called one of the teachers a “former porn star”, the district tried to shut it down. The pupils cried censorship; the district backed off. Then both the pupils and the teacher headed to court. Before the smoke cleared, both sides were suing not each other, but the LA school system. In March, a jury awarded the teacher a cool $4.35m.

An increasing number of pupils and their parents are taking disputes from the classroom to the courtroom. They are suing schools in record numbers, siphoning money out of education, costing taxpayers millions and prompting federal legislation to shield teachers from frivolous claims. Pupils say they simply exercising their rights, but school officials feel they are the latest victims of America's obsession with litigation. They point to particularly daft recent cases: the student who sued his school in Washington state because he was bullied for being gay, or the two Connecticut baton-twirlers who sued their school after their coach cut them from the cheerleading squad.

A 1999 survey found that one in four public school principals had been involved in a lawsuit, up from one in ten in 1989. This has driven up school insurance rates across the country by about 15%, according to the Insurance Information Institute. Typically, the courts chose to preserve teacher authority over pupils' rights. But school superintendents say it hardly matters who wins. Before the cases ever reach court most schools succumb to what they call “legal blackmail”, settling just to avoid lawyers' fees.

Take Joseph Cirasuolo, a Connecticut school superintendent, who spends almost as much time these days dealing with legal issues as educational ones. He has to. If a parent disagrees with the school, he knows they could show up with their lawyer. Mr Cirasuolo has settled six cases in the past three years alone, at a cost of $240,000 to the district's taxpayers. “The attorney approaches the superintendent,” he explains, “and says, “You give us $30,000-$50,000 and we'll go away. The school realises that even if we win, attorneys' fees will cost more than that. So we settle.”

Although civil-rights cases grab most of the media attention, the majority of recent lawsuits against schools involve a controversial special education law, which is up for reauthorisation this year. The Individuals with Disabilities Education Act, which dates back to 1975, requires all America's schools to provide whatever services are necessary to guarantee a “free and appropriate” education to all students. This can mean something as simple as allowing a slow reader an extra 15 minutes to do an examination. But in the case of more complicated disabilities, the law can require the school to provide a child with a private tutor, a personal nurse, speech therapy, individual busing or bilingual services.

According to the law, a school must test a child for special education within 30 days of a parent's request. If the child qualifies, it must draw up an Individualised Education Plan (IEP). If parents and school cannot agree on whether the pupil qualifies, what services the child needs, or whether the school is fulfilling the IEP, the parents can sue the school. And they do.

Well-intentioned though the law may be, teachers complain it is so complicated that lawyers can make an easy career out of schools' failure to comply. Poorer schools say they cannot meet the specific needs of “individualised” children when they are so strapped by teacher shortages, discipline problems and financial woes. Wealthier schools complain that astute parents—many of them lawyers themselves—use the threat of a lawsuit to get special privileges for their children. The number of students identified as “special education” has doubled to 6m in the past 20 years and continues to grow.

The federal government threw in its two cents last year with the Teacher Liability Protection Act. This

limits the amount of “pain and suffering” damages that can be awarded against a teacher, although unions say it does not go far enough. Many states have taken matters into their own hands with laws limiting liability; in Arkansas, for example, school districts cannot be sued for an amount higher than their insurance cover. But such state immunity does not protect schools from accusations of federal civil-rights violations, and there are plenty of those.

Many schools now offer teachers courses in how to avoid being sued. These include guidelines on “appropriate touching” (a pat on the shoulder is allowed) and comments that may prove risky (“You have a nice smile”). The LA school district, which has appealed the $4.35m award, has hired a team of lawyers to revamp the whole department. “We're looking for minefields to avoid lawsuits,” said Donald Davis, a lawyer for the district. “When a judgment is paid, that doesn't put books in the classroom.”

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The genie in the wings

Jun 6th 2002
From The Economist print edition

George Bush doesn't think much of economists. Is Glenn Hubbard an exception?

WASHINGTON opinion is more or less agreed: the Bush foreign-policy team is full of first-rate professionals, but the top economic officials are a bit of a joke. Gaffe-prone Paul O'Neill has come closer to a laughing stock than any recent treasury secretary. Last seen wandering around Africa with a rock star, Mr O'Neill, ostensibly the administration's top economic official, has been quietly written off as an entertaining oddball.

Larry Lindsey, the head of the National Economic Council and the top economist in the White House, has a reputation as a self-promoting ideologue with his own share of gaffes (for example, calling the Enron crisis a “tribute to American capitalism”). John Taylor, the top international man at the Treasury and the most luminous academic economist on the Bush team, is dismissed by outsiders and insiders alike as incapable of making a decision. In short, after an administration dominated by economists (Larry Summers, Mr Clinton's last treasury secretary, was the most prominent of a huge cast), Mr Bush's economic crew seems decidedly short of talent at the top.

That is true, but only in part. For Team Bush has one economist who makes up for some of these inadequacies, and whose star appears to be rising. Glenn Hubbard, the chairman of the Council of Economic Advisers (CEA), is carving out a surprisingly high-profile role. Whether on television talk shows or in front of businessmen, Mr Hubbard presents the administration position on everything from tax cuts to the economic recovery. Telegenic in a nerdy kind of way, articulate and gaffe-free, Mr Hubbard, unlike his colleagues, is both safe and presentable.

More interesting is his rise inside the administration. The post of CEA chairman carries prestige, but not always influence. The council, set up 56 years ago to dispense independent economic advice to the president, is traditionally less political than the rest of the White House. Its role has often been to point out painful economic truths—and be ignored. In 1984 Don Regan, Ronald Reagan's treasury secretary, famously told congressmen to throw away a CEA report that was critical of the rising budget deficit. In the economist-packed Clinton administration, the CEA was a respected but back-seat player.

No longer. Mr Hubbard wants the council to be more than what he calls an “academic consulting firm”. Though he disclaims any increase in his own importance, he has had surprising success. The CEA now formulates tax policy alongside the Treasury. Mr Hubbard is the administration's point-man on Japan. Insiders say that, when Mr Bush recently nominated two new governors for the Federal Reserve, the names were the ones Mr Hubbard had suggested.

This growing influence has several causes. In part, Mr Hubbard's academic background—particularly his prominence as a conservative tax economist—dovetails well with the Bush tax-cutting agenda. Mr Hubbard knows a lot about the things Mr Bush cares about. Equally important, the CEA has benefited from shortcomings in the rest of the economic team, particularly at the Treasury. Mr Taylor's timidity, for instance, allowed the CEA to move into the international arena. Mr Hubbard has also gained from other people's ambition. With both Mr Lindsey and Mr Taylor visibly fancying themselves to succeed Alan Greenspan as chairman of the Federal Reserve, it is perhaps unsurprising that Mr Hubbard won the day on nominations for governors at the central bank.

To purists, the Hubbard strategy has also involved compromising academic integrity. An op-ed in the

Washington Post late last year, in which Mr Hubbard argued that “It is a major fallacy to praise new spending plans as stimulus,” was widely criticised as a triumph of political expediency over economics. No economist could argue with a straight face that spending, other things equal, is not stimulative. To many, this proved the CEA had abandoned the moral high ground of independent policy analysis for the sullied waters of political trench-warfare.

There is something to this charge, but the important question is whether it has been worthwhile. Has Mr Hubbard's rising prominence translated into better economic policy in the Bush administration? In other words, have the CEA's good ideas become Bush policy, or (arguably more important) has the CEA been able to kill bad ones?

Tracking his influence

It is surprisingly hard to find much administration policy that began its life at the CEA. One point on which the council prevailed was a pilot-scheme to offer a lump-sum benefit for workers displaced by trade. The lump-sum approach has economists' fingerprints all over it, since it distorts peoples' incentives less than the existing scheme, where benefits end when a worker gets a job. But it looks unlikely to emerge in the final congressional legislation.

A fairer test is the CEA's effectiveness at stopping stupid policy. Here the record is mixed. By all accounts, Mr Hubbard's main success has been to preserve market principles in the face of terrorism. Several of the supposedly free-market Bush team, for example, wanted the government to provide insurance against terrorism at no charge. Mr Hubbard, appalled, argued that terrorism insurance should be priced, perhaps through an auction. Though he did not get the idea very far, the administration's position—which includes co-payments and deductibles—ended up more market-oriented than when it started.

Unfortunately, the list of items where Mr Hubbard has fought and lost is uncomfortably long. From steel tariffs (which he opposed) to climate policy (where he unsuccessfully proposed mandatory emissions caps and tradeable permits), this administration has often placed politics above economics. The test of whether Mr Hubbard truly has the president's ear will be how far he can convince Team Bush to curb that habit.

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Canada's political conflict

Jean Chrétien v Paul Martin: now it's really war

Jun 6th 2002 | OTTAWA AND TORONTO
From The Economist print edition

AP

The prime minister, left above, and his (now ex-) finance minister, right, have dominated Canadian government for most of ten years. Now they're openly at war

Get article background

THE Liberal Party has governed Canada for the past 8½ years, indeed most of the past 100. Today, it looks ready to tear itself apart, even if only temporarily, over the rivalry between Jean Chrétien, prime minister since 1993, and Paul Martin, who has been his finance minister all those years—and reckons it is now time he had the top job. After months of crossfire, Mr Martin on June 2nd lost his post.

Did he jump, or was he pushed? The two men disagree. Mr Martin admits he was “at the edge of the Rubicon”, supposedly over policy differences with the prime minister—which is odd, since Mr Chrétien is often criticised for having no distinct policy—but claims he was still considering his options when he heard on the radio that he had been replaced by John Manley, the deputy prime minister. Mr Chrétien says Mr Martin “quit”.

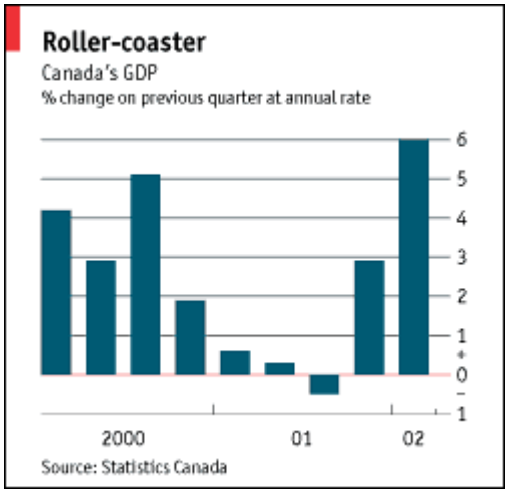
Whatever the detail, Mr Martin had at least climbed out on the window-ledge. But Mr Chrétien, having lost a popular and effective finance minister, now faces a party in deep disarray and near-revolt. The stage is set for civil war over the months up to the party convention next February, when delegates from its 301 constituency associations will vote on the leadership.

The skirmishing has already begun. Mr Chrétien faced a broadside on June 3rd, when he gave Parliament his version of the break. His brief tribute to Mr Martin's good work brought a lengthy standing ovation for the former finance minister. A caucus meeting on June 5th left Liberal MPs bitterly divided, with some demanding that Mr Chrétien stand down now.

The two men's rivalry goes back to 1990, when Mr Chrétien returned from a short spell in law practice to take over leadership of the Liberals, by then in opposition. Mr Martin, a successful businessman and first-term MP, came a strong second in that leadership vote. When the Liberals won the 1993 election, Mr Chrétien gave him the finance portfolio, and the pair worked in apparent harmony to end the era of budget deficits and, through tax reforms and astute management, to put the economy on a sound basis. This helped the Liberals to win again in 1997 and 2000.

But as Mr Chrétien, who was 68 in January, kept hinting he might

want to stay in office for yet a fourth election, his heir-apparent, who is little more than four years younger, grew impatient. Mr Martin's father had come second to Lester Pearson in the leadership stakes a generation before, and the younger man has clearly wanted to redress history by winning the top job. He has worked tirelessly to that end.



In recent months the infighting had come to the surface. Martin supporters control most of the constituency associations, and have successfully resisted rules that would allow massive recruitment by Chrétien loyalists or other would-be leaders to challenge that control. Lately, a number of scandals relating to government and other contracts have rocked the cabinet. Mr Chrétien had to pack one public-works minister off to Denmark as ambassador, and then demote his successor for taking a holiday in a contractor's lakeside home. On May 26th he dismissed his defence minister, Art Eggleton, when a newspaper revealed that the minister had secured a C$36,000 ($23,500) contract for a former girlfriend to write a 14-page report.

Rightly or wrongly Mr Chrétien suspected that Mr Martin's friends had been leaking tales of such scandals to the media, and denounced him in a heated cabinet meeting on May 30th as a “destabilising influence”. He also ordered all would-be successors—who, besides Mr Martin, include Mr Manley and the industry minister, Allan Rock—to stop their thinly veiled leadership campaigns. Mr Martin responded by saying publicly that he would have to review his options. Mr Chrétien duly pushed him out, saying he would relish a fight at next February's convention.

On thin ice

Reaction in newspapers that normally support Mr Chrétien's government has been hostile: columnists have used phrases like “dead man walking” to describe him. His popularity, which began to dip after the Liberals lost two by-elections in mid-May, is slipping. One poll says 68% of voters want him to quit. Mr Martin is notably more popular in Quebec—Mr Chrétien's home province—and in the west, besides being well entrenched in Ontario, most important of the provinces.

Mr Chrétien need not worry about a cabinet revolt and may use the power of fear to quell dissidents in his 170-strong caucus. Nor, with such a majority, need he be anxious about a no-confidence vote in Parliament. But Mr Martin is remaining as a backbencher, and everyone assumes he will be organising for the leadership vote in February. On the way, there will be scattered struggles through the autumn to win or retain control of Liberal constituency associations and thus of the selection of delegates to the party convention.

Mr Chrétien meanwhile will have other preoccupations, such as chairing the G8 summit this month and running the country. In contrast, Mr Martin, buoyed up by public esteem for his success in his past post, will be free to travel and canvass local associations, advancing policies of his own—a new financial deal for cities will probably be one—calculated to win him the post he hopes for in future.

The Martin legacy

Success? Canada's economy had a lacklustre 2001, did it not? True, but look at the statistics released two days before Mr Martin lost his job: growth at an annual rate of 6% in the first quarter of this year. This week the Bank of Canada felt it must respond by raising its target for the overnight interest rate from 2.25% to 2.5%, the second rise in seven weeks. Then look at the doubts about recovery south of the border.

The growth owes something to recent—and reversible—rises in energy prices: Canada is a net oil and gas exporter, in notable contrast to its neighbour; indeed, thanks to a new offshore field, Newfoundland, poorest of the ten provinces, is expected to lead them all in growth this year. Overall, the balance of payments is well in the black.

Longer-term too, Canada has been fortunate. A free-trade pact with the United States in 1988, followed

in 1993 by the North American Free Trade Agreement (which includes Mexico), put pressure on many businesses to become more efficient. “We've become much more export-intensive,” says Aron Gampel, deputy chief economist at the Bank of Nova Scotia in Toronto. A weak currency also helped. And Canada escaped some of the telecoms and dotcom excesses that marked the American economy in the later 1990s.

Yet Canadians also owe a good deal to their former finance minister. When Mr Martin took over in 1993, the federal deficit was almost 6% of GDP; for the past five years the budget has been in surplus, and still is, despite tax cuts. Under Mr Martin, the national debt shrank from two-thirds of GDP to about half.

Yet voters' memories and gratitude are fickle. Canadian cities, especially Toronto, remain in the grip of a feverish housing boom: permits for new homes were 68% higher in April than a year earlier. New car and truck sales were 10% higher in May. Households still have much less debt than do American ones. If Mr Manley, who has promised to stick to his predecessor's priorities—balanced budgets, reduced debt, low inflation, tax cuts and “key investments”—can ensure calm, steady growth, will it be Mr Martin who gets the thanks?

To achieve steady growth may not be easy. Business is confident: its spending on plant and equipment was healthily up in the first quarter. But, though many Canadians may be tempted to believe otherwise, their economy cannot prosper for long without vigorous growth in the giant to the south. The United States buys 85% of Canada's exports, and Americans are by far the biggest foreign investors.

The converse risk is overheating and a crash stop. The central bank, fearful that spare capacity is dwindling, raising the risk of inflation, has made plain that it will hike rates yet again if the economy goes on galloping ahead. Economists would not be surprised to see the overnight rate at 5% by mid-2003—and maybe higher still, if the Liberal leadership battle encourages Mr Chrétien and Mr Manley to undo Mr Martin's good work by trying to spend their way to popularity.

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Uruguay and Argentina

Don't watch my lips

Jun 6th 2002 | SAO PAULO
From The Economist print edition

Argentina's troubles have hit its small neighbour—whose president hit back

IT WAS not exactly diplomatic, but... Frustrated at seeing his country dragged down by the economic horrors of neighbouring Argentina, Uruguay's President Jorge Batlle exploded with anger this week when a television reporter asked about the similarities between the two countries' situations. Shouting and banging his fist on his desk, Mr Batlle launched a tirade against what he called the "bunch of thieves, from top to bottom" across the River Plate. Argentina would be all right if only its politicians stopped stealing for a couple of years, he snapped. Its president, Eduardo Duhalde, "doesn't have any support, he doesn't know where he is going".

Mr Batlle later said he hadn't realised the camera was still rolling, and he dashed to Buenos Aires to make grovelling, indeed tearful, apologies. But he had only said out loud what many Uruguayans (and Argentines) think. His outburst followed a nerve-racking few days in which it looked as if Uruguay was succumbing to the Argentine "contagion" that it has been fighting for months. As Uruguayans began pulling their savings out of the banks, the credit-rating agencies feared a repeat of Argentina's debt default (also presaged by a run on the banks) and hurriedly downgraded Uruguay's bonds. This triggered a plunge in the Uruguayan peso, further increasing the burden of dollar debt.

With disaster round the corner, on May 28th the International Monetary Fund rode to the rescue, for the second time in two months, offering Uruguay a further big loan—perhaps $1.5 billion or so, when the details are worked out—on top of the $930m it lent in March. Top-ups from the World Bank and Inter-American Development Bank should leave Uruguay with a total of $3 billion to bolster its reserves and defend the banking system. Its bonds and currency recovered sharply.

The rescue came as Mr Batlle pushed through his second package of emergency spending cuts and tax rises this year, aiming to close a yawning deficit in the government's accounts. In responding so swiftly, the IMF seemed to be sending a message to Argentina: look how we help those who help themselves. In recent days, following months of delays, Mr Duhalde has at last achieved some of the Fund's preconditions for a rescue: Argentina's three big provinces have been arm-twisted—the last, Santa Fe, signed up on Tuesday—into agreements to cut their deficits and stop issuing private quasi-currencies; and an "economic subversion" law, used to persecute foreign bankers, has been repealed. But there are still doubts about Mr Duhalde's scheme to solve the banking crisis by letting savers swap their now frozen deposits for bonds. The IMF fears it will fail unless the swap is made compulsory.

It was Argentina's erratic handling of its banking woes that set off Uruguay's panic, explains Ernesto Talvi of CERES, an economic think-tank in Montevideo. Argentines had been trickling across for months to withdraw money from their Uruguayan bank accounts. Last month this became a flood, after Argentina's central bank prevented one of its banks, Banco Galicia, from sending cash to its Uruguayan offshoot. Alarmed at the growing queues of Argentines pulling out their money, Uruguayans rushed to follow suit, fearing their government too might impose a freeze.

The IMF rescue has still to prove durable. Like their president, Uruguayans are exasperated at an economic downturn that is in its fourth year and seems only to get worse. The government's austerity packages have been accompanied by pot-banging street protests and calls for the sacking of Alberto Bension, Mr Batlle's finance minister. However, Uruguay's political class is more mature, and less

loathed, than Argentina's, says Adolfo Garce, professor of politics at the University of the Republic. So, he predicts, the protests will not deflect the ruling centre-right coalition from backing Mr Bension in his drive to balance the budget by 2004.

Even the left-wing opposition, despite its demands for the government to get the economy moving again, accepts that public spending should be cut (though there is little agreement on where the axe should fall, apart from such obvious fripperies as ministers' limousines and a loss-making state-owned whisky distillery). Some reforms are being pushed through: the near-bust state mortgage bank is being recapitalised, but with tough controls on its lending. But the government has backtracked on a controversial plan to make the state telecoms firm seek private partners.

Earlier this year, it looked as if Argentina's neighbours would be able to avoid serious trouble from its economic collapse. That is not so sure today. With the left-winger Luiz Inacio Lula da Silva far ahead in opinion polls for Brazil's coming presidential election, that country's *real* has plunged in recent days. Paraguay's guarani has also slumped. In both countries, as in Uruguay, market confidence has been undermined by a lack of progress on painful but necessary reforms. The region's political leaders have some reason to blame Argentina for their misfortunes. But they are not blameless themselves.

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About sponsorship

Resisting development

People matter too

Jun 6th 2002 | LIMA AND SANTIAGO
From The Economist print edition

In Peru and Chile, a few small farmers defy giant corporations

THERE'S not much new in the stories: miners, ranchers and loggers, railway and road builders, industrialists and dam-constructors have been trampling over peasants since modern business began. And a lot richer as a result, sooner or later, most of their victims' descendants have become. But there was one unusual feature in two such tales, from Peru and Chile, this week; the peasants have hit back.

The valley of Tambo Grande, in far-northern Peru, grows fruit; limes, notably, and mangoes. A Canadian firm, Manhattan Minerals, has found richer treasures there—copper, silver, gold—and has an option to mine for them. The fruit-farmers and the families of the main town, where two-fifths of these peasants actually live, hate the idea: it would smash up their valley, their livelihoods and indeed their houses, they fear. Nonsense, says Manhattan, it'll handle the valley like fine china, it won't force anyone to move out of the area it wants to mine and it will offer new houses to anyone who chooses to go.

Oh yeah, replied the citizens of Tambo Grande last weekend. In a referendum organised by the local council, with financial aid from foreign environmental groups, three-quarters of the 36,000 eligible voted, and some 95% of those voted no.

The vote binds no one. And Peru, a poor country stashed with underground resources and not much else, cannot easily afford to spurn any offer of foreign investment to develop them. But in these post-Fujimori days it is also run by a government that has to listen to its electorate.

In Chile, that has been true since the country returned to democracy in 1990. The objectors here are fewer: a handful of families that refuse to leave land that Endesa, a giant Spanish power company, wants to flood for a new hydroelectric dam. But the issues are more complex, for these are indigenous "Indians".

The Ralco dam in south-central Chile, already more than half-complete, straddles the upper valley of the spectacular Biobio river, home to the Pehuenche Indians, close kin of the more numerous lowland-dwelling Mapuches. Endesa has resettled most of the 93 families whose land would disappear under the reservoir. But six have refused its succulent offers. "Our ancestors are buried here; we can't trade them in for money," argues Hilda Riquelme, the six families' spokeswoman.

Unless they change their minds, the courts will have to decide. A law introduced after 1990 protects indigenous communities' property rights. But it does not rule out compulsory purchases in the public interest—and Chile needs the power, says Endesa. Besides which the company would have a $540m dam sitting unused.

It is pressing the authorities to intervene. The National Energy Commission agrees that it would be "crazy" for the dam not to operate. But the centre-left government, already coping with a long-running conflict between the Mapuches and logging companies, is trying to stay on the sidelines. Ralco, it claims unpersuasively, "is, in essence, a private problem."

Mapuche groups are increasingly active in the affair. "When they start to fill the reservoir, we Mapuches will be there to defend the Pehuenches," says Aucan Huilcaman, spokesman of one of the main organisations. Like Ms Riquelme, he can envision Mapuches and Pehuenches tied to the trees as the water gradually rises, presumably to be dragged away by the police under the glare of television lights.

The rights of the fauna

Any such thing would damage relations with all the ethnic minorities, admits Jaime Andrade, the government's co-ordinator for indigenous affairs. Especially, it would inflame the Mapuches' grievances about logging. This conflict, played up in the media, discourages investment—which the poor Mapuche areas badly need —and diverts attention to the crude issue of law and order from the real one, that of indigenous rights.

Despite repeated promises, the indigenous peoples are still not formally recognised in the constitution. They have little opportunity to shape decisions crucial to their interests. The majority “take away your identity, and then think it's all right if they throw you a few public services,” argues the Mapuches' Mr Huilcaman.

The process of approval for big projects such as the Ralco dam includes no special provisions for consulting Indian communities. “They just get a mention in environmental-impact studies, along with the rest of the fauna,” as Jose Bengoa, an expert on Mapuche history, caustically puts it. That classification mirrors the attitude of many Chileans. Even in Santa Barbara, the town closest to Ralco, myths about the Pehuenches abound. “It's no good giving them better housing—they just put animals in the bedrooms,” says a 22-year-old. He went to school with Hilda Riquelme.

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Conflict in Kashmir

The worries of Musharraf

Jun 6th 2002 | LAHORE AND DELHI
From The Economist print edition

As war fever mounts, Pakistan's leader is negotiating a potentially deadly sequence of domestic constraints

Reuters

Get article background

TO THE West, Pervez Musharraf is the indispensable man. Pakistan's president turned over his former Taliban allies to the coalition against terror and is now helping it hunt down al-Qaeda fighters who may have fled into Pakistan from Afghanistan. Though a dictator, he is a modern sort, seemingly more interested in literacy than in *jihad*. His is the heartbeat between Pakistan's nuclear weapons and people who think like Osama bin Laden.

India's view is less rosy. This satrap of the anti-terror coalition masterminds terrorism against India, aimed at wresting Kashmir, a mainly Muslim state, from Indian rule. When India threatens to answer this proxy war with conventional war, by mobilising its army along the border, Pakistan brandishes its nuclear weapons. But even Indians admit that if General Musharraf fell, what came after might be worse.

Worries about the general's longevity colour almost everything that goes on in the region. They are one reason the West is desperate to head off a war between India and Pakistan, which could lead to the general's downfall. These worries have not deterred outsiders from demanding that he end infiltration by terrorists across the line of control (LoC), which divides Kashmir into Indian and Pakistani zones.

But they may inhibit the general doing so decisively. He has certainly been an accomplice of the anti-Indian militants, but he is also, potentially, their victim. Peace may depend on whether he fears their ferocity more than India's army and international pressure combined. At the moment, he believes he is doing just enough to keep India at bay. He insists that terrorists are not crossing the LoC.

India's prime minister, Atal Behari Vajpayee, refused to meet General Musharraf at an Asian summit in Kazakhstan this week. Afterwards, though, he suggested joint patrols of the LoC, a hint of reconciliation. Two high-powered Americans, Richard Armitage, the deputy secretary of state, and Donald Rumsfeld, the defence secretary, were on their way to the region to push General Musharraf to keep the terrorists in check, and to urge India to reciprocate. On Wednesday, George Bush urged the Pakistani and the Indian leaders to, as his spokesman put it, “step back from the abyss”. But even pleas from the world's most powerful man may not halt the path to war, in part because General Musharraf may not do enough to satisfy India.

Intelligence sources in India say that Pakistan's Inter-Services Intelligence agency (ISI), which orchestrates the militancy, has merely asked terrorists to lay low for four to six weeks. This will be extended, Pakistanis say, if India responds. The fighters in turn have asked for fresh ammunition, if not fresh blood, for the 3,000 militants already in place in Indian Kashmir. Indian intelligence suspects that hundreds of “porters” are poised to bring in new supplies from Pakistan's side.

Why might General Musharraf risk letting them through? Belief in Pakistan's right to rule Kashmir is the marrow of Pakistani patriotism, and no one is less likely to question that than the chief of an army that exists to achieve it. Then there is the risk that respectable people take when they hire hit-men: the thugs may turn on them. The militants operating in Kashmir are part of an underworld in which *jihad*-waging men of violence, like al-Qaeda members and their ilk, call them a “mafia”, consort with worthier sorts,

like intelligence men, generals, even scientists.

General Musharraf has convinced the United States that there is no better man available to shut this mafia down; indications are growing that the mafia would like to get rid of him. Divide and rule is the worried general's current policy for dealing with the mafia. Al-Qaeda and home-grown “sectarian” groups, which kill Muslims they disagree with, are to be stamped out, even though they are a source of zealous cannon fodder for Kashmir. Kashmir-oriented groups, meanwhile, are to be handled more tactfully, partly to keep pressure on India and partly to discourage them from making common cause with other *jihadi* groups.

The backlash has begun. Recent massacres by extremists at a church in Islamabad and a hotel in Karachi, directed mainly at foreigners, are also a warning to the regime. If the Kashmir contingent joined them, General Musharraf could face graver threats. The crunch will come if and when India offers a reasonable solution to the Kashmir dispute. The *jihadis* are likely to reject it, and the general will have to decide whether to drive them out of business and into the arms of other extremists or to prolong the conflict with India.

Meanwhile, the general believes, they strengthen his bargaining power with India. On their own, other forces against him are a lesser threat. In three years as Pakistan's leader, General Musharraf has largely bleached out the Islamist colour given to the armed forces by a former dictator, Zia ul Haq. The top ranks have been purged; many lower-level officers with over-zealous views are being discreetly retired. The general can now count on an officer corps that is loyal to him and moderate in ideology. That includes the head of the ISI, Ehsan ul Haq.

He has handled Pakistan's political parties less deftly. Most of these are moderate by instinct but capable of being vindictive. General Musharraf seized power from politicians and has governed as an anti-politician. He regards Benazir Bhutto and Nawaz Sharif, the exiled former prime ministers who lead the two main political parties, as corrupt, and has made little attempt to work either with them or with their followers. The two parties are likely to win most of the seats in parliament when elections are held in October. Unless he shares power with at least one of them he will find himself politically orphaned, facing a hostile parliament ready to exploit any vulnerability.

A deal on Kashmir that could be construed as a sell-out would be a perfect opening for the general's foes. Even the army's loyalty might waver. To get a favourable deal, it suits Pakistan's strongman to look powerless. India, though, will remain sceptical. Its view is that the Kashmiri militants depend so heavily on the ISI for equipment, transport and money that it can cut them off anytime it likes. The rest of the world wants the terror to stop, too, but worries more about the consequences for General Musharraf. If he stumbles, the malevolent forces at work in Pakistan might break free.

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India

If...The mechanics of escalation

Jun 6th 2002 | DELHI
From The Economist print edition

How, step by step, a border war could turn nuclear

THE battle lines are clear. On one side perch the doves who accuse India of “complacency”. However justified its rage at cross-border terrorism, they say, India does not understand that punishing Pakistan with a military strike could lead to a nuclear war. The American Defence Department says that 12m people could die. Unwarranted panic, retort most Indian strategists, along with the bulk of Indians. India has said it would not be the first to use nuclear weapons, and would give Pakistan no cause to use them on India, provoking a counter-attack that would destroy Pakistan. The doves are simply caving in to its nuclear blackmail, they say.

AP

Even a nuclear one?

Who is right? The doves, probably. The risk that a conventional conflict between India and Pakistan would escalate into a nuclear one is low, but not negligible. The strategists' case for safe reprisal lies in the modesty of its aim. India is not considering the conquest of Pakistan, or any offensive that might look like an attempt at conquest, such as a drive towards the Punjabi city of Lahore, just across the border.

India's offensive would be aimed primarily at the terrorists themselves, who congregate in camps on Pakistan's side of the disputed state of Kashmir. Artillery fire across the line of control that divides the state, already intense, could be stepped up. Indian forces could capture Pakistani posts, maybe even seize a few kilometres of territory, which would help it interdict militants trying to cross the line. A further step up the ladder would be to bomb the camps from the air.

The point, say analysts, would be to bleed Pakistan, as Pakistan has bled India for two decades. India is bigger and richer, and so can afford more artillery shells than Pakistan, and a more prolonged deployment of its army along the border. Its aim, says Jasjit Singh, a defence expert, would not be “a grand victory but sustained pressure that will slowly alter policies.” He expects retaliation. But Pakistan's weaker air force is unlikely to engage India's in full-scale combat. Pakistan could open up a land front somewhere in India outside Kashmir, which might prompt India to counter-attack elsewhere in Pakistan. But this would “stay a local border war”.

It might. Wars escalate, though, because one side prefers the next step up the ladder to defeat. “Once you've expended the resources of going to war it's hard to say, ‘I don't want to use this next piece',” says Douglas Campbell, director of the Centre for Strategic Leadership at the Army War College in the United States.

In past wars, Pakistan has tried to cut off Indian Kashmir from the rest of India. That prospect could prompt a pre-emptive strike by Indian tanks into Pakistani Punjab. Victory there would give India conventional dominance, says Sam Gardiner, an American defence consultant. The war simulations in which he has participated almost always end with a nuclear exchange. No one knows what, if anything, would prompt General Musharraf to push the button. His assessment of India's intentions, instincts shaped by his daring career as a commando, his sense of political security, perhaps the intensity of his religious faith, could all play a role.

Pakistan has made so many statements about its nuclear “red lines” that it is “confusing itself”, says Mr Singh. But India's signals are also garbled. The powerful home minister, L. K. Advani, has suggested that India would like to split up Pakistan as it helped to do in 1971 when East Pakistan became independent Bangladesh. The foreign minister, Jaswant Singh, says India is “definitely committed” to Pakistan's territorial integrity. It would lower risks if all India's top leaders repeated that daily.

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Defence in East Asia

China feels encircled

Jun 6th 2002 | SINGAPORE
From The Economist print edition

America's foreign policy has sharpened a sense of isolation

AP

Wolfowitz is cool to China

AT LAST, defence ministers from across East Asia have found a way of gathering in one place to discuss their security concerns. A conference in Singapore organised by the London-based International Institute for Strategic Studies (IISS) provided the venue last weekend for what many defence establishments in the region, as well as the United States, hope will become an annual event. It needs to be.

Most crucially it is needed in order to enhance transparency in a region that received about $10.6 billion in arms deliveries in 1999, about as much as the Middle East and North Africa, and which is riven by mutual suspicions and rivalries. China's secretive military modernisation and Japan's efforts to expand its security role could change the strategic environment of Asia, as could potential conflicts in the Korean peninsula, the Taiwan Strait and the South China Sea.

Although East Asia has long had an institution for discussing security matters, the ASEAN regional forum, this has floundered amid a region-wide disdain for formal, multilateral security arrangements. Defence officials have played only a marginal role in it. The director of the IISS, John Chipman, believes having “an institution disguised as a conference” is a good way to proceed. He says all participants have agreed to return next year, including those invited from further afield, Britain, India, Australia, New Zealand and the United States, which sent its deputy defence secretary, Paul Wolfowitz.

Getting China to open up will be the biggest challenge. Chinese delegates at the conference said China would publish a new “white paper” setting out its defence policy, probably at the end of the year. But western diplomats say this is highly unlikely to mention the issues of biggest concern to Taiwan, Japan and some others in the region. They are the rapid build-up of short-range ballistic missiles on China's coast facing Taiwan, and the purchase of sophisticated weaponry from Russia, including destroyers, submarines and fighter aircraft. “Of course, regarding transparency, we might have different standards, or criteria,” said a Chinese participant. “Each country has its own secrets.”

The conference organisers say China has at least agreed to send its defence minister next time. This time, a middle-ranking official stood in for him (the minister excused himself in order to hold talks in Beijing with his Russian counterpart). And some experts see signs of a glacial shift in China's security strategy. “We are beginning to see signs of willingness by China to think more multilaterally”, says a western defence analyst in Beijing. This includes a more positive attitude towards taking part in United Nations' peacekeeping operations, at least in support roles. Some diplomats see China's support for the American-led military campaign in Afghanistan as a departure from its policy of opposing armed intervention.

But the Pentagon's standoffishness towards the Chinese military has not been helping. Hardliners in the American Department of Defence are enraged by China's handling of the collision of an American EP-3 surveillance aircraft with a Chinese fighter jet in April last year which caused the death of the Chinese pilot. China detained the American crew for 11 days and insisted the surveillance plane could leave China only after being cut into pieces. Following the incident, the Pentagon ordered that military-to-military contacts with the Chinese be subject to stricter reviews. Only low-level exchanges have been approved, much to China's chagrin.

Higher-level contact could help to allay Chinese misgivings. Many Chinese strategists openly worry about what they regard as the encirclement of China by American power in the wake of the September 11th terrorist attacks. American troops have been deployed in Central Asia, an area where China has been trying to expand its influence. America has also strengthened its defence relationships with Japan, the Philippines and China's close ally Pakistan. “It is possible that the stationing of American troops in Central Asia will be prolonged. This could remould the strategic configuration of the area, presenting a challenge to China's security and strategic interests,” says a Chinese researcher, Deng Hao, in *International Studies*, published by a government-sponsored think-tank.

China's sense of unease has been further heightened by Russia's new partnership with NATO, though in public it is not critical: it values the pretence of its own “strategic partnership” with Russia too highly. At the end of this week, leaders from China, Russia and four Central Asian states were meeting in St Petersburg for a summit of the Shanghai Co-operation Organisation, a group that aims to enhance joint efforts to combat terrorism and separatist movements in Central Asia. But this largely ineffectual effort by China to involve itself in Central Asian security will do little to counterbalance America's growing influence there.

Later this month, an American assistant secretary of defence, Peter Rodman, will visit Beijing for talks on ways to revitalise military-to-military contacts. It will be tough going. Some Pentagon officials believe that little has been gained from such encounters so far. American officers complain that the Chinese counterparts they meet are usually well-groomed English speakers in jobs far removed from policymaking or military leadership.

America's need for international co-operation in its fight against terrorism has helped to overcome resistance in the Pentagon to fuller defence relations with China (though in Singapore, Mr Wolfowitz offered perfunctory acknowledgement of China's assistance, while praising other Asian countries). Many in the State Department, and President George Bush himself, believe that engagement is worth pursuing even if the rewards are not always apparent. America's allies in Asia and Europe agree. “Engagement is a way of encouraging them to take a less Sino-centric view,” says a European diplomat in Beijing.

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Japan's little firms

Small mercies

Jun 6th 2002 | TOKYO
From The Economist print edition

The remedy for big problems

Get article background

COMPARED with some of Junichiro Koizumi's fiery slogans, Haruo Shimada's description of desired reforms sounds disarmingly modest. The prime minister talks boldly of “reform without sanctuary”. Mr Shimada, who advises him, simply asks you to picture a Japan with “500,000 small firms, making people happier and providing services that they badly need”. Yet although Mr Shimada says this without squinting, setting his jaw or chopping a hand in the air, the Keio University economist is advocating the same drastic changes that Mr Koizumi still says he wants. For in Japan it will be hard to make people happier or provide decent services without overhauling the entire small-business sector, and much of the country's political economy along with it.

Messrs Koizumi and Shimada are hardly alone in wanting to tap the benefits of small companies. Countless Japanese pundits and officials harbour visions of eager young engineers and computer whizzes clustering together to churn out new technologies and jolt the economy to life. Bureaucrats at the trade and economy ministry want to promote closer links between university scientists and the private sector, to which they attribute much of America's success. They also talk up schemes to channel more money to small firms with promising new technologies.

Low-tech counts too

They are right to lament Japan's relative lack of small high-tech companies. But the trouble with this single-minded focus is that the rest of the country's small-business sector is also crying out for change. Solving these problems requires the sort of changes that Mr Shimada wants.

James Kondo, a McKinsey consultant in Tokyo, points out that, besides high-tech firms, two other groups of small companies need fixing. One operates in service sectors tightly controlled by the government, running child-care centres, nursing homes and so forth. These outfits enjoy lots of subsidies and little competition, and are closely connected to powerful factions in the ruling Liberal Democratic Party. The other group operates more freely in the private sector, but is just as inefficient, running outfits from food-processing plants to mom-and-pop retail stores on a scale far too small to achieve rich-country levels of productivity.

Both of these groups of small firms warrant very different treatment from that of the high-tech firms the bureaucrats adore. Far from nurturing them, a decent reform programme would take steps towards putting them out of business, either to be replaced by consumer-friendly private services (the first group) or closed down to boost scale and efficiency (the second). Mr Shimada argues that the social-care sector should be deregulated, stripped of its subsidies and opened up to competition. This will face opposition from the usual vested interests, but could transform a large sector of the economy.

Could Japan introduce such a change? Surveys have confirmed that consumers are not satisfied with existing services. Sensible reforms are likely to be popular with the voters. With Japanese women caught raising children while caring for two sets of parents, a push for better old-age and child care could win over many of them, along with the elderly. Hence Mr Shimada's interest in a swathe of independent small-scale social services, from nursery schools and nursing homes, to physical rehabilitation centres and preventative health-care services.

If pitched the right way, Mr Shimada believes, it would be easy to build widespread support for changes.

If competition can be paired with spending cuts, this could also release money to smooth the transformation of the mom-and-pop sectors. And perhaps best of all, argues Mr Shimada, overhauling social services is a great way to generate jobs in an ageing society. “Sum them all together,” he says, “and they could be ten times bigger than Toyota or Sony.”

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Norfolk Island

Murder in the South Pacific

Jun 6th 2002 | SYDNEY
From The Economist print edition

The police are baffled

THE people of Norfolk Island, in the South Pacific, felt no need to lock their houses or take the keys from their cars. There had been no crime of any consequence on the island for as long as anyone could remember. That easygoing atmosphere changed two months ago when a woman was murdered. With the murderer still at large the residents have increasingly been regarding each other with suspicion.

On the evening of March 31st, Easter Sunday, the body of Janelle Patton, a 29-year-old Australian, was found wrapped in plastic on a picnic ground overlooking the ocean. She had been stabbed repeatedly. Miss Patton, from Sydney, had lived on Norfolk Island for two years. On the morning of her murder she had worked her usual shift at a hotel and was later seen taking a walk along a path leading to a lookout spot.

Police flown in from Australia—Norfolk Island is under Australian administration—appear to be baffled. They are still not certain whether Miss Patton was the victim of a random attack or if she knew her killer. They have issued questionnaires to all 1,800 residents, and to 700 tourists, asking them to account for their movements on the day of Miss Patton's murder.

The murder has reminded Australia of the island's murky history. It was a notorious prison during Australia's early colonial era when it was known contemptuously as “Gomorrah Island”, a place where Britain sent the worst convict re-offenders from New South Wales and Tasmania, men and women alike, to be flogged into submission by “skinners” or “backscratchers”. To be banished to Norfolk Island was considered a fate worse than being hanged. Robert Hughes, a historian of convict Australia, described the penal system as “the pit that England had created...whose very bottom was Norfolk Island”.

In 1856, after the convict settlement closed, descendants of the *Bounty* mutineers moved from Pitcairn Island to Norfolk Island. About half the island's residents are now “Pitcairners”, with the rest from Australia and New Zealand. It has become a place where writers and tourists go to find peace. Along the foreshores young people leave their surfboards on beaches from one week to the next without fear of having them stolen. All that may now change. “It's had a huge impact on attitudes,” said Nigel Erskine, director of the Norfolk Island Museum. He thinks twice about allowing his children to roam their island home. People are even doubtful about their neighbours, he says.

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Democracy in the Maghreb

Where voting is a parlour game

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From The Economist print edition

Reuters

The democratic trappings in Algeria, Tunisia and Morocco

A POLICEMAN taunts a young voter leaving a polling station in Bab El Oued, a seedy district of Algiers. “So, you got your visa?” In a country where jobs and housing are out of reach of most young people, getting a visa—that is, casting a pro-government ballot—may be their only hope of jumping the huge queue to a government salary or flat.

Like its quieter neighbours, Tunisia and Morocco, Algeria maintains plenty of democratic trappings. It has a feisty press. An alphabet soup of parties, including Islamist ones, has just contested parliamentary elections. Yet the outcome of the vote was never in doubt. Whether it is Tunisia's president-for-life, Morocco's powerful court clique, known as the *Makhzen*, or Algeria's shadowy *Pouvoir*, the Maghreb's ruling circles all indulge in democracy more as a parlour game than as a decision-making procedure.

Some parts of the game are similar in all three countries. The nationalist card is a sure winner when it comes to blasting human-rights groups as foreign meddlers. The old tactic of brandishing the menace of fundamentalism to silence the middle classes has been newly popular since September 11th. But the rules vary widely.

In prosperous little Tunisia, they are super strict, making for the dullest play. Except for a handful of lapdog leftist parties and a relentlessly harassed gaggle of human-rights groups, opposition, in effect, is outlawed. Last month, the president of the past 15 years, Zine el-Abidine Ben Ali, swept a referendum amending the constitution to allow him up to 12 more years in office, plus judicial impunity for life. Backed by a 130,000-strong police force, an adulatory state-controlled press, and a ruling party whose membership comprises a fifth of Tunisia's 10m population, he won a farcical 99.52% yes vote from a 99.56% turnout. Fun for Mr Ben Ali, but one dissident, writing to an Internet forum, describes the experience as “a nightmare where you scream but no sound comes out”.

The playing field is far flatter in Morocco, where King Mohammed VI has been genuinely popular since succeeding his tyrannical father in 1999. Here, the Socialist party that heads the coalition government was once in the opposition. A dozen other parties, including a mildly Islamist one, hold seats in parliament, and free elections are promised for September. Yet trade unionists, human-rights activists and harder-core Islamists all accuse the country's politicians of being too timid to take on the palace by tackling corruption or pressing for needed reforms. Criticising the king, the army or Morocco's claim to the disputed Western Sahara is still banned. Last month, a cleric in Fez earned a six-month jail sentence for his unacceptably fiery sermons.

In Algeria, the same “crime” might have been paid for by sudden death, or by forced flight to join the

Islamist guerrillas who still prowl the hills outside the capital. There are far fewer of these rebels since a 1999 amnesty. The monthly toll from massacres and army sweeps has fallen from thousands at the height of the civil war to fewer than 100 today. A semblance of normal life has returned. But that normality includes raging social ills, rampant corruption, a socialist-legacy economy that takes six weeks to cash a cheque, and poverty so stark that families spend two-thirds of their income on food.

Since the May 30th elections, normality also includes a return to parliamentary majority for the FLN, the national liberation front that won Algeria's independence from France in 1962 and a subsequent quarter-century of one-party rule. The result was no surprise. The party that the FLN unseated was itself a recent creation of the *Pouvoir*, the narrow class of generals, apparatchiks and crony businessmen that is thought to run the country. A pair of “loyal” Islamist parties continue in the opposition.

Turn and turnabout

The FLN's comeback may have been helped by a purge of old party stalwarts in favour of younger, more popular figureheads. Most Algerians, however, appear convinced that what it really reflects is the *Pouvoir*'s struggle to reconsolidate its grip after the years of violence. Sustaining the illusion of alternation in office, in this view, is simply an attempt to palliate both the public and international opinion.

By official count, some 54% of Algerians did not bother to vote, the lowest turnout in the country's history. Many responded to boycott calls from a range of opposition groups that included two of the leading secular parties. The loudest protest came from the Kabylia region east of the capital, a stronghold of the Berber minority who make up perhaps a third of Algeria's population. Here, the boycott was total.

Since last spring, what began in Kabylia as a movement demanding ethnic Berber rights has snowballed into a mass insurrection that many Algerian analysts believe has national resonance. “It is not really about identity any more,” says an Algiers businessman. “It is about justice, and this feeling is everywhere in Algeria.” By his reading, Islamists are no longer the main threat to the *Pouvoir*: the real problem is their own ineptness. He predicts more repression, more violence, and perhaps, at the end, real democracy.

Having wrestled with its Islamist demons, Algeria may be ripe for such a wrenching transition. Morocco could probably achieve the same result with less pain, and Tunisians, who mostly appear baffled by their government's repressiveness, are certainly ready for greater freedom. “We are more politically mature than our leaders,” says a Tunisian exile, expressing a sense felt across the region. All three countries have embraced the idea of open markets, and have young populations that are better educated than their parents. Perhaps most important, the new generation holds a new kind of “visa”. Radio, satellite television, the Internet and millions of relations overseas link them to other, more attractive, ways of doing things.

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Israel and the Palestinians

Can reform stop the bombers?

Jun 6th 2002 | JERUSALEM
From The Economist print edition

Not as things are

AP

Get article background

Carnage at Megiddo

THE heat engulfing Yasser Arafat increased on June 5th, when a suicide bomber in a car blew up an Israeli bus at Megiddo (the biblical Armageddon) killing 17 of the passengers, 13 of them soldiers. Although this latest act of terrorism was claimed by Islamic Jihad, and condemned by Mr Arafat who says his Palestinian Authority (PA) will arrest the people behind the bombing, it will still strengthen those inside the Israeli government who hold that Israel's military retaliation should include getting rid of Mr Arafat, once and for all. As a warning shot, the Israeli army launched a raid on Mr Arafat's headquarters in Ramallah, destroying property and killing two Palestinians.

The bombing will also strengthen Ariel Sharon's arguments when he meets George Bush in Washington next week. Under prodding from the Egyptians—President Hosni Mubarak is seeing Mr Bush later this week—the Americans are contemplating calling for a regional peace conference this summer to lay down a timetable for an early declaration of Palestinian statehood, followed by “final” negotiation on what that state should be. Mr Sharon has always believed and argued that the political process must wait until the PA is reformed, and Palestinian violence is under control.

The day before the bombing, Mr Arafat had given the CIA chief, George Tenet, his proposals for unifying the PA's scattered security forces. His plan boiled down to reducing their number from 12 to six, with himself as head of a new Palestinian National Security Council. Nobody was impressed. Mr Tenet reportedly did not think much of it. Nor did Muhammad Dahlan, the young security chief from Gaza who has been vocal in demanding reform of the security forces, and who is said to be the man that America would like see running them. He stood down from his Gaza post, and is taking a month's “vacation”.

Palestinians in the street are equally unenthused. The men who will be heading the six “new” forces are the same officers whom they accuse of leaving them defenceless during Israel's attacks on West Bank towns. Nor are they much keener on the other rumoured reforms emanating from Mr Arafat's headquarters, such as a miserly “streamlining” of the Palestinian cabinet from 32 ministers to 24, and the promise of new elections early next year. None of this approaches the fundamental changes that, according to opinion polls, are deeply desired by over 90% of West Bank and Gazan Palestinians.

In the past week, Islamist and radical national groups have all turned down places in a new Palestinian cabinet. Instead, they urge elections, and unity based on an agreed programme. America expressed its relief that these militant factions were excluding themselves. But Mr Arafat's own Fatah movement is unhappy at the “cosmetic” nature of the changes.

Last week, its leading Revolutionary Council came down clearly against all attacks inside Israel. It called for discipline to be exerted over the militias that launch them, and said that the protection of Palestinians is the responsibility of the PA's own forces. But it wants these forces to be answerable to an elected Palestinian parliament, and not involved in political negotiations with Israel.

If there was change of this sort, say Fatah leaders, the dissident factions—which include Hamas, Islamic Jihad and Fatah's own radical splinter groups—could be persuaded to confine their armed struggle to the occupied territories themselves. But a reform package that sets out to ensure Israel's security at the

expense of the Palestinians', especially while the Israeli army is invading Palestinian cities, will not, say the Fatah men, hold for long.

A sharp example of Mr Arafat's dilemma occurred earlier this week when, on June 3rd, the Palestinian High Court, which under a decree issued last month is newly independent of the executive, ordered the release of Ahmad Saadat, leader of the Popular Front for the Liberation of Palestine (PFLP). The PA had arrested Mr Saadat in January on the basis of Israeli charges that he had masterminded the PFLP's assassination of an Israeli cabinet minister, Rahavam Zeevi, last year (itself a reprisal for Israel's assassination in August of the former PFLP leader, Abu Ali Mustafa). Mr Saadat was eventually transferred to a PA jail in Jericho, under American and British supervision, as part of a deal on May 1st that saw Mr Arafat freed from his Ramallah office.

Since Mr Saadat had never been charged by the Palestinians with any crime, the High Court decreed that he should be freed. Israel's defence minister, Binyamin Ben-Eliezer, immediately announced that should Mr Saadat be released, Israel would not be bound by agreements regarding Mr Arafat's freedom, and would take the “necessary steps”.

Under pressure, Mr Arafat announced that Mr Saadat would remain under the PA's “protective custody” because of Israeli “threats”. At this, Hamas announced that a Palestinian Authority “under the barrel of Israeli guns” could never bring reform. It urged the Palestinians instead to put their faith in armed resistance. The next day came Armageddon.

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South African immigration

Want them, throw them out

Jun 6th 2002 | KRUGERSDORP
From The Economist print edition

A flawed new law will not solve the country's shortage of skills

AFTER six years of complaints and wrangling, President Thabo Mbeki signed a controversial immigration bill into law on May 30th. The new law is supposed to ease South Africa's chronic shortage of skills by allowing educated foreigners to work in the country. But nobody believes it will do this. Ministers call it flawed, and Mr Mbeki himself says it does “not address all these matters that we wanted”.

South Africa urgently needs more skilled workers, perhaps as many as 500,000, says Iraj Abedian, chief economist with Standard Bank. Schools and universities do not produce enough home-grown talent, and many educated people, most of them white, left when apartheid came to an end. Despite an estimated 40% unemployment rate , there are not enough qualified people to fill vacancies in hi-tech industries, engineering, finance, medicine and much else besides. The obvious solution would be to import workers, particularly from other African countries where there are fewer jobs and, sometimes, good education systems. But a clumsy apartheid-era law, the Aliens Control Act, has prevented this, as have a suspicious attitude towards foreigners and an impossibly bureaucratic immigration process.

Look at what happened to Matshiyakwakhiwe Dlada. After completing an apprenticeship as a boiler-maker in Bulawayo, Zimbabwe, he found no work at home, so he moved to Johannesburg last October, and was immediately offered three jobs. But he could not get a work permit and last month he was picked up by the police and dumped in the Lindela deportation centre in Krugersdorp. This week he was shivering there, together with another 1,400 illegal immigrants, mostly Africans, waiting to be sent home.

A foolish quota system

An estimated 3,000 people are deported from South Africa each month. Others fail to get into the country in the first place. Foreign investors who want to bring in their own employees have had to prove to the Ministry of Home Affairs that a local person could not do the job equally well, a long and troublesome process.

The new immigration bill was designed to open the borders by cutting the paperwork. It also raised a levy on each foreigner employed. In its early stages it was broadly welcomed, at least by larger businesses. But squabbling between the home-affairs minister, Mangosuthu Buthelezi, who leads the Inkatha Freedom Party, and his African National Congress colleagues kept the bill from being passed. Then last-minute amendments by the ANC introduced a quota system for foreigners, which requires officials to decide how many skilled workers each type of industry requires. Since a constitutional deadline ordered that the new law be enacted by June 2nd, the amendments stuck.

Now Mr Buthelezi has been told to reform the new law, removing the quota system, even while his department is obliged by the constitution to begin implementing it. Reform is likely to be slow because of political sniping between coalition partners. Mr Buthelezi is furious at the ANC's meddling and wants his original ideas restored. Nor are South Africa's civil servants likely to find imaginative ways of solving the problem, for instance by setting extremely large quotas. “There is a mindset here that outsiders will steal our jobs,” laments Mr Abedian.

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Judging Rwanda's genocide

Justice on the grass

Jun 6th 2002 | GITARAMA
From The Economist print edition

Hasty, informal trials will ease the congestion in Rwanda's jails

EPA

Waiting years for a day in court

EIGHT years after the genocide, Rwanda still has 115,000 suspects in jail awaiting trial. The courts cannot cope, not least because so many jurists were murdered or fled the country in 1994. At the current pace, it will take over a century to try them all. Justice delayed is justice denied, especially since the suspects must wait in prisons so crowded that inmates have to sleep in shifts in wooden bunks stacked to the ceiling. So the government has decided that all but the most serious cases will be heard by grassroots tribunals, known as *gacaca* courts, starting next week.

Gacaca is an old system. Disputes between Rwandan families were traditionally solved by all those concerned sitting down on a patch of grass (*gacaca*) and stating their case, after which a village elder made a judgment. *Gacaca* courts are widely trusted. And the system is swift. There is little paperwork, and the judges—an incredible 250,000 of them, all elected—receive only basic training and wages that just compensate for missing a day tending their fields.

Suspects will be brought to the villages where they allegedly committed their crimes. Everyone who was there will testify, and a panel of 19 judges will rule. The *gacaca* courts will try ordinary murderers, but not those who gave the orders. *Gacaca* judges can impose sentences of up to life imprisonment, but not the death penalty.Those who merely destroyed their neighbours' property will be released and ordered to repair the damage. Being local, *gacaca* judges should be knowledgeable about the cases they hear, but perhaps not perfectly impartial. Many are still reeling from the trauma of 1994. Some avoid the word “genocide”, preferring to talk about “massacres” or “that unfortunate event”.

In Gitarama province, where perhaps 120,000 people were chopped or clubbed to death, “mixed” marriages are common, which means that many judges have seen their families sundered. One judge, Agnès, is a member of the Tutsi tribe (the genocide's main victims), but married to a Hutu. She saw her family murdered in 1994. Her husband saved her life, but after the genocide was stopped by the Tutsi army whose leaders now rule Rwanda, he was accused of taking part in the killings and thrown in jail. Agnès may see the man who saved her standing accused before her neighbours. In the words of the law student who trained Agnès to be a *gacaca* judge, this “won't be easy for her.”

Rwanda has recovered remarkably, considering how recently a Hutu government tried to exterminate all the Tutsis. In crowded towns, Hutus and Tutsis share mud-brick houses, one family per room. On rural hillsides, Tutsi survivors invite Hutu neighbours to their children's weddings; the choice is either to invite

those who killed their relatives, or no one. Hutus feel excluded from government; Tutsis feel insecure in their power. By giving Rwandans a chance to talk about what happened, and to punish the guilty, the *gacaca* courts may foster reconciliation. At the very least, they will free some of those who were wrongfully imprisoned in the chaos that followed the genocide.

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Expanding the European Union

Is the venture now in peril?

Jun 6th 2002 | BRUSSELS
From The Economist print edition

Doubts are growing about the European Union's plan to sign up ten new members by the end of the year

Get article background

RELENTLESS optimism has always come naturally to the builders of the European Union. Their can-do spirit helped launch the idea in the 1950s and later brought about a single market and a common currency. A similar approach has marked the EU's efforts to expand the current club of 15 countries to embrace former communist countries further east. True, it has all taken a long time, with tough political decisions and applicant countries having to absorb 80,000 pages of EU law. But EU officials have always insisted that what they call the reunification of Europe is an historic inevitability. Earlier this year, they announced an ambitious plan to close the deal with ten applicants at a summit in Copenhagen in December, with luck ensuring that the likes of Poland and the Czech Republic become fully fledged members of the club in 2004.

But doubts are creeping in. Günter Verheugen, the European commissioner in charge of enlargement, says that the “window of opportunity” is closing. Three specific problems are looming ever larger. First, the candidate countries and the EU are still arguing over the financial implications of enlargement, particularly when it comes to the billions of euros the EU spends each year on agriculture and aid to poorer regions. Second, as Mr Verheugen puts it, there is a “new political climate” in Europe with the rise of populist anti-immigration parties in a string of EU countries. Third, there is a chance that Irish voters will again reject the EU's Nice treaty, which is deemed essential to give enlargement a green light. Taken alone, none of these problems needs be lethal. Combine them, however, and enlargement, the Union's biggest new project, might be in danger.

The negotiations' final stages were always likely to be fraught. Fairly poor countries with a great many farmers, such as Poland, could badly strain the EU's budget, 80% of which goes to farmers and poor regions within the Union. To lower the tension the commission has proposed that farmers in applicant countries should at first get only a quarter of the amount that farmers in current EU countries already get, but spread out over ten years they would eventually get the same whack. All the applicant countries say this is grossly unfair and that their farmers cannot be expected in such circumstances to compete with richer western neighbours. But current members have the opposite concern. They worry that the rapid build-up of direct payments to eastern farmers over ten years will prove very expensive very fast—and make the long-promised reform of Europe's Common Agricultural Policy all but impossible.

In a normal political climate, a compromise would be found. The trouble is that the rise of politicians like France's Jean-Marie Le Pen, Austria's Jörg Haider, Italy's Umberto Bossi, the late Pim Fortuyn's disciples in the Netherlands and the Danish People's Party, shows that populist and xenophobic movements are gathering strength in Western Europe. That will make it harder for mainstream politicians to sign a generous deal with the applicant countries as well as to accept other consequences of enlargement, in particular the free movement of workers from the east.

Mr Haider has already proved adept at provoking fears and disputes about enlargement, demanding, for example, that the Czechs close down a nuclear plant near the border with Austria and repeal laws that dispossessed ethnic Germans after the second world war. The French elite has always had deep reservations about the political and financial implications of enlargement. Diplomats from countries which want to join fear that the French may be stalling for time.

It is not yet politically acceptable in Western Europe to oppose enlargement openly. Even Mr Haider says he broadly favours it. So the opponents of enlargement need an opportunity to call a halt. The voters of Ireland may soon give them one. The Irish constitution says that any EU treaty that requires constitutional change must be approved in a referendum. This applies to the Nice treaty, as it contains a series of painfully negotiated changes to European institutions that were designed to ensure that they will still be able to function in a much bigger Union.

All EU treaties have to be ratified by every member state, but Irish voters have already rejected Nice once in a referendum last year. Though the Irish government is gearing up for a second vote later this year, there is rising speculation in both camps that the Irish people may again say no. That, says Mr Verheugen glumly, would create a “very, very serious problem and I have no answer to the question of what we could do.”

Mr Verheugen's dire warnings may partly be a gambit to squeeze the Irish into voting yes. In any event, there may be a twisty legal way to circumvent an Irish no that would keep enlargement on course. The deeper worry is that an Irish no to Nice would offer even more evidence of Europe's frostier climate. People already in the Union need a spirit of hope, generosity and openness to embrace those poorer countries that were once on the wrong side of the iron curtain. West European voters these days seem increasingly fearful and introspective. No wonder that Poles, Czechs, Hungarians and others still keen to join the club are feeling rather edgy.

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Spain and its Basque terrorists

Trying to shut them up

Jun 6th 2002 | MADRID
From The Economist print edition

Spain's government is trying to silence ETA supporters. Will that help?

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EPA

Otegi's view of Aznar

FOR Spain's conservative prime minister, Jose Maria Aznar, banning Batasuna, the political wing of the violent Basque separatist group ETA, is a logical step in the war against terror. But a lot of Basques, including many of those opposed to ETA and its terrorism, disagree. With the ban due to come into force later this month, the influential bishops of the Basque region's three biggest cities, Bilbao, Vitoria and San Sebastian, signed a pastoral letter full of misgiving. Not for the first time, Mr Aznar has rattled a worryingly large number of moderate Basque nationalists he may need on his side if he is eventually to subdue the terrorists of ETA.

The new law will let the government ban any political group deemed to "promote hatred, violence and civil confrontation". It will also be illegal to challenge Spain's existing democratic institutions. Batasuna does both. Though the party says it is independent, Batasuna's leaders have always deferred to ETA's commanders. Batasuna rallies usually end with black-hooded ETA people joining Batasuna leaders on the podium to shout "Gora ETA! (Long live ETA!)". Local councillors who belong to Batasuna habitually refuse to back motions condemning ETA attacks, even when fellow councillors have been murdered.

In their letter the bishops took care to denounce violence. "Peace is incompatible with terrorism," they said. But, they added, "it is wrong to create a climate where 'anything goes' in the fight against terrorism." Outraged, the government has called on the Vatican to bring the bishops to book. Mr Aznar, who survived an ETA car bomb six years ago, before his party won power, described their attitude as "morally and intellectually repulsive".

The Basques' regional premier, Juan Jose Ibarretxe, who belongs to the non-violent Basque National Party, accused Mr Aznar of being unable to accept any ideas that differ from his own. Other prominent Basques, however, have backed the bill. The head of the Basque employers' organisation said it would make it easier to stop ETA from levying its "revolutionary tax" on businessmen.

Another big effect of the bill is that it may be used to cut off the state funds that have hitherto been given to Batasuna, along with all parties represented in local and national politics. A lot of the cash for Batasuna, it is widely reckoned, ends up in ETA's hands. If Batasuna is banned, its candidates will be ineligible to stand in local elections, where they usually do best. In the last poll for the European Parliament in the Basque region, during an ETA truce in 1999, Batasuna got nearly 20% of the votes. But it got only a tenth in a regional poll last year, after ETA began killing again.

After some vigorous arm-twisting by the government, the Socialist opposition and the nationalist coalition that runs Catalonia voted for the bill in parliament, while the Basque Nationalists, along with the far left and the Galician nationalists, voted against. The bill must still go to the senate, which is bound to nod its approval.

Mr Aznar decided to bring in the new law after failing to silence Batasuna with existing ones. On May 27th the Supreme Court annoyed him by ruling that Arnaldo Otegi, Batasuna's leader, had broken no law by shouting "Long live the Basque homeland and freedom!", thereby hailing ETA by its full name, at a rally on the other side of the border with France. In a similar display of judicial independence in 1999,

the Constitutional Court made the government free 22 members of Batasuna's top committee. They had been imprisoned because ETA members featured in a state-funded party advertisement on television in 1996.

Such irritations may soon be a thing of the past. But will that help Mr Aznar make ETA and its political wing, which may well reappear in due course in another guise, less menacing? Many in the Basque region and quite a few outside it think not.

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Denmark's immigration law

We're full up too

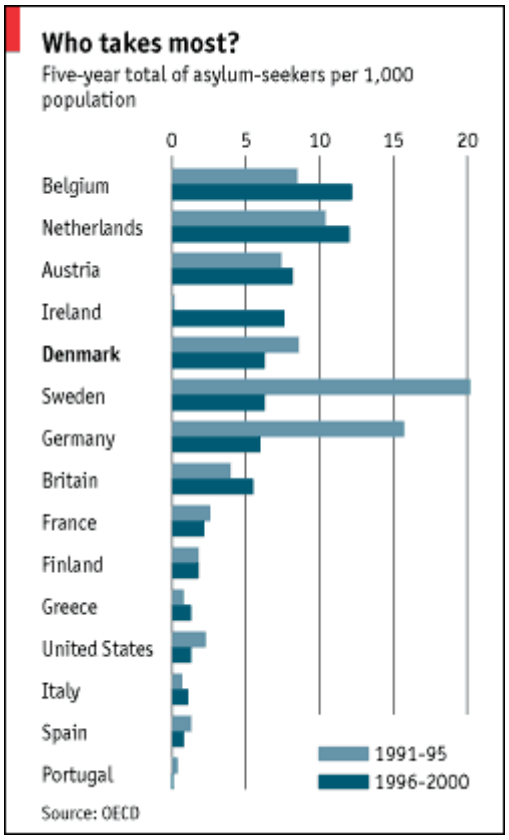
Jun 6th 2002 | COPENHAGEN
From The Economist print edition

The Danes say other Europeans may copy their immigration rules. Really?

THE centre-right government of Anders Fogh Rasmussen repeated its “three fundamental considerations” when it forced through controversial new rules on immigration last week. First, it would honour Denmark's commitments to international conventions on refugees and people who have been persecuted. Second, it was determined to stem the flow of incoming foreigners and make state welfare for them less generous. Third, it would promote new ways to assimilate foreigners already in Denmark. The package takes effect on July 1st, the day that Denmark takes up the EU's six-month presidency.

The second consideration is the most controversial. Only long-time residents will have full access to Danish state welfare. Newcomers, whether asylum-seekers or other kinds of migrants, will have to wait seven years before getting permanent-residency permits to entitle them to full unemployment benefit. This means, for example, that an out-of-work couple with four children will see its monthly cash benefits nearly halved from DKr21,044 ($2,660) to DKr10,578 during that seven-year period.

Another novelty is that Denmark will consider granting asylum only if the application is made in Denmark itself; embassies and consulates abroad will no longer serve as conduits. And under the new laws, the definition of a refugee will become more rigorous. The Danes will henceforth consider taking in people only if, as the Geneva Convention puts it, they have a well-founded fear of persecution on grounds of race, religion, nationality, membership of a particular social group or political opinion. Conscientious objectors or people fleeing war or famine will have no legal right to be deemed refugees, though the government may in exceptional cases grant them a lesser “protection status”.



The government policy also places curbs on people seeking to live in Denmark in order to join family members already there. Bertel Haarder, Denmark's minister for refugee, immigration and integration affairs (who is also his government's Europe minister) says that many of those given residence permits in the past are young people in forced or arranged marriages. Now couples under the age of 24 will no longer be able to get residence permits; those who are older will have to meet conditions concerning the size of their homes and their incomes. Even indigenous Danes will find it hard to bring in foreign spouses.

Mr Fogh Rasmussen's coalition government is a minority one. To get his package through, he needed the votes of the anti-immigration Danish People's Party, which holds the balance of power in parliament—and says the new measures are just a first dainty step.

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Turkey's drifting government

What next?

Jun 6th 2002 | ANKARA
From The Economist print edition

The prime minister is too ill to run the country. But the alternatives are all iffy

AP

Ecevit isn't giving up yet

LAST week was a busy one for Turkey's powerful National Security Council, where the top generals and politicians discussed such big questions as the abolition of the death penalty, easing bans on broadcasting in Kurdish, and ways to break the impasse over the divided island of Cyprus, all matters needing resolution if Turkey's progress towards joining the European Union is to continue. But Bulent Ecevit, the country's 77-year-old prime minister, was nowhere to be seen. He has a spinal disorder, Parkinson's disease, a cracked rib and an intestinal problem. Can he stay in office much longer?

Commentators in the mainstream media and leading industrialists are among those calling for him to step down. But severe risks attach to just about all the alternatives. Some suggest that a deputy prime minister, Husamettin Ozkan, who belongs to Mr Ecevit's Democratic Left, should take over as caretaker, letting the same government carry on with the economic reforms being overseen by the IMF in exchange for its promised loan of $16 billion.

But one of the main figures in Turkey's ruling three-party coalition, Devlet Bahceli, strongly hinted that he would resign if anybody other than Mr Ecevit were prime minister (except, presumably, himself). Mr Bahceli heads an ultra-nationalist (some call it neo-fascist) party whose forebear, in the 1970s and 1980s, was engaged in street violence and racketeeering.

Mr Ecevit says that if he were to step down (and his protective wife Rahsan is still discounting that possibility), the president would ask the leader of the party with most seats in parliament to form a new government. At last count, Mr Ecevit's was ahead of Mr Bahceli's by just one seat. But Mr Bahceli is trying to persuade MPs from other parties on the right to join his, so making himself the front runner to take the top job.

If Turkey's non-executive president, Necdet Sezer, asked Mr Bahceli to head a new coalition, the IMF and the EU would both be appalled. Though he is much less ferocious than he was, Mr Bahceli's politics and economics are still pretty hairy. He is firmly against lifting the death penalty and still wants the captured Kurdish rebel leader, Abdullah Ocalan, hanged. He inveighs against easing bans on Kurdish-language education and broadcasting. And he is inclined to make populist promises that would scupper the IMF's efforts to put Turkey's budget back into shape.

Or, if parliament fails to find a new government, the president could call a general election. This, however, would bother a lot of secular-minded Turks, especially the country's influential generals. For opinion polls suggest that Recep Tayyip Erdogan, an Islamist former mayor of Istanbul, would sail to victory at the head of his Ak, or White, party. The United States, too, twitches at the prospect of Mr Erdogan taking over, lest he be loth to co-operate against terrorism and ends Turkey's cosy military relationship with Israel. Moreover, Mr Erdogan might be reluctant to endorse the IMF's proposals.

The man the West would like to see in charge is Kemal Dervis, who was brought over last year from the World Bank to deal with the country's mangled finances. So far he has excelled. But he too has drawbacks. For one thing, he has no political party. For another, he has an American wife and a German mother, which might make the conservative rural masses think him too foreign. So western diplomats are touting a next-best option, with Turkey's urbane foreign minister, Ismail Cem, a member of Ecevit's

party, taking the helm and Mr Dervis still running the economy.

But even this has snags. Mr Cem would find it difficult to secure the backing of a majority of MPs. And if there were a general election, pollsters say that neither his party nor the other two in the government coalition would even cross the threshold of 10% of the national vote to get seats in parliament. It is hard to see how Mr Erdogan's lot can be kept out of power in the longer run (a general election is due by April 2004 at the latest) unless parliament passed a bill to lower the threshold to let other parties in. But the generals might not like that either, because one of their bogeys, the pro-Kurdish People's Democracy Party, would then probably get seats.

Every way you look, the upshot is untidily fluid. But Turkey, a strategic pivot between Europe and the turbulent Middle East, needs a fit prime minister. Many Turks now think that rules out Mr Ecevit.

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Private pension funds in France

Still a dirty word

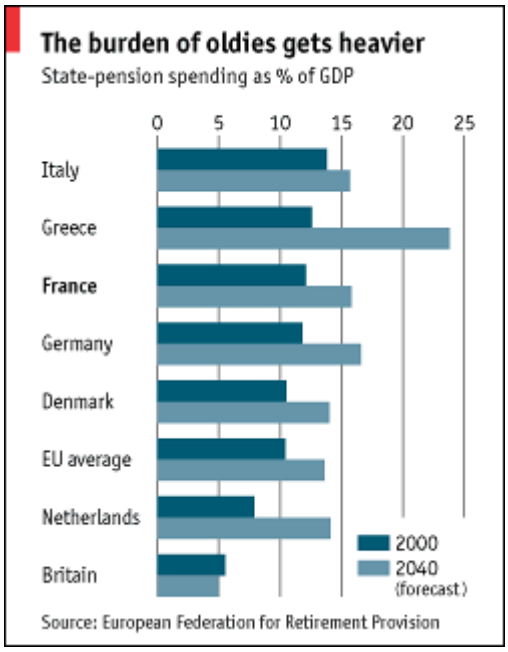
Jun 6th 2002 | PARIS
From The Economist print edition

Can France reform its pensions without strikes and street protests?

FOR ten years French prime ministers have been trying to reform their country's pension system—largely in vain. In 1993 Edouard Balladur introduced some reforms for private-sector pensions. Two years later Alain Juppé had to abandon more drastic reforms after protests caused mayhem across the country. When Lionel Jospin came to power in 1997, he promised "diagnosis, discussion and decision" but, after a report he had commissioned called for urgent action, he funked it. If President Jacques Chirac's allies on the mainstream right win the two-round general election on June 9th and 16th, he knows he and the new prime minister should have another go. Whether he has the courage to do so is another matter.

France lags behind other European countries in pension reform. Even welfare-minded Germany has brought in partially private funding while determining to keep pension contributions, paid jointly by employee and employer, below 20% of wages for the next two decades. If Germany has begun to move, say French reformers, surely their country can too.

Like most European Union countries, France's pension system is pay-as-you-go (PAYG): those in work pay for the pensions of those already retired. As France's population (like others in the rich world) gets greyer, with people living longer and having fewer children, the number of workers paying for pensions is going down as the number of retirees goes up. Today, ten workers pay for four retirees, but by 2040 they will have to pay for seven. The cost of pensions, according to Jean-Michel Charpin of the state planning agency, may rise from about 12% of GDP today (and 4.4% in 1960) to 15.1-16.7% by 2040.



Bike, baguette and beret = a big burden

France's PAYG covers the so-called first and second pillar, the state and private sectors. The *régimes spéciaux*, or special pension schemes, of public-sector workers, who count for a fifth of the labour force, are a lot more generous than those in the private sector. Private-sector workers are covered by a *régime de base*, or basic scheme, provided by the state, as well as obligatory top-up schemes for employees and executives in the private sector. Public-sector pensions are paid according to a worker's number of years in work, with a minimum of 37.5 years' service to qualify for the full whack, based on the average gross wage of their ten best-paid years. With the gradual introduction of Mr Balladur's reforms, a private-sector worker's pension is based on a minimum of 40 years' work for full benefits and on an average gross wage of his 25 best-paid years. Pensions are indexed to salaries in the public sector but to prices in the private sector, which tends to help public-sector workers more because salary rises usually outstrip price rises. The public-sector workers retire at 60 against 65 in the private sector. In sum, public-sector workers do a lot better.

Yet public-sector workers tend to win public sympathy when they take to the streets to defend their perks. In 1995 Mr Juppé tried to align public and private pension arrangements by, for instance, making public-sector workers contribute for 40 years to qualify for full pensions. He coupled his pension reforms with other unpopular measures, such as freezing public-sector wages. When irate public-service workers went on strike, paralysing air and rail travel across the country, public opinion forced Mr Juppé to cave in.

After that experience, governments have tried to reform pensions by stealth. After the Socialists won a

general election in 1997 and Mr Juppé was thrown out, his plan to encourage private pensions was dropped. But last October the Socialist-led government launched a voluntary long-term savings scheme known as PPESV whereby workers get tax-breaks and their contributions are deducted from wages which are then topped up by employers. “It's a pension fund in disguise but the government avoided using that ideology-charged term,” says Stéphane Déo at UBS Warburg, a bank. Mr Chirac recently dared to talk of “pension funds *à la française*”.

Even so, any serious pension reform is almost bound to bring people on to the street. The three big trade unions are still against radical change. The Democratic Confederation of Labour has been more amenable but it too helped make the mayhem that spiked Mr Juppé's plans seven years ago. The leader of the Communists' General Confederation of Labour, Bernard Thibault, who ran the campaign in 1995, is still in charge, though he has sounded a bit more conciliatory of late. The third big union, *Force Ouvrière*, is now more open to discussion but still wedded to the current system. “Enron and the Maxwell scandal show what happens when you have private pensions,” says one of its leading figures, Bernard Devy.

If a centre-right government emerges after this month's election, it would have five years in which to push through painful reforms. But it remains unclear whether it would have the guts to press on if tumult once again ruled the streets.

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Charlemagne

Why French politicians fear the street

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A centre-right president and a centre-right government may yet recoil before the mob

“MAY '68”. No French baby-boomer needs a translation. The date is code for that heady period of their youth, when the students of Paris fought stone-throwing battles with the riot police and imagined they were about to topple the Republic in the name of freedom and social revolution. Most of the *soixante-huitards* (68ers) are now tamely respectable, their girths spreading in tandem with their bank balances. But they can always indulge in comforting nostalgia. They really did change France, didn't they? And for the better, *bien sûr*.

So will May 2002 become similarly engraved in the collective consciousness, code for a time when the French, especially the young, “went down into the street” in their hundreds of thousands to turn back a tide of xenophobic fascism embodied by Jean-Marie Le Pen in his bid for the presidency? Perhaps. More than 1.4m people are said to have demonstrated against Mr Le Pen on May Day. That set the tone. Four days later, the centre-right Jacques Chirac was re-elected president with an unprecedented 82% of the vote. Bravo then for the demonstrators, saviours, so it seemed, of the nation's honour.

Yet a couple of problems surely niggle. The more obvious, given that this weekend and next the voters will be electing a National Assembly, is the ambiguous character of Mr Chirac's re-election. Clearly, his massive vote came in large part because the left joined forces with the moderate right to forestall Mr Le Pen. But if this has created a momentum which on June 16th leads to a right-wing majority in parliament, the left will say it has a right to feel aggrieved. Having acted in May for the good of the nation, they will have connived in their own defeat in June.

To which there is a ready counter. The voters have three times within two decades chosen to saddle a president from one side of the political divide with a National Assembly dominated by the other side—witness the past five years, when President Chirac was condemned to “cohabit” with the Socialist-led government of Lionel Jospin. So they can still choose a fourth cohabitation. And if they do not, then too bad for the left: after all, it has complained often enough that cohabitation does French democracy and French government no favours.

But there is a second reason why the thoughtful may temper their praise for the May Day demonstrators with a smidgen of doubt. Arguably, the louder the voice of the street, the quieter the voice of parliament. Carry the argument to an extreme, and the rule of parliament gives way to the rule of the mob.

That, of course, is not how most French citizens see things. Instead, “going down into the street” is part of the national identity, to be cherished rather than criticised. Think back to 1789 and the Revolution. Where else in the world does a national newspaper regularly print a map warning readers not just of roadworks but also of street protests? It is only foreigners who react with amazement to the country's plethora of strikes and demonstrations. Fishermen, farmers and lorry-drivers are the old favourites; new ones are doctors, lawyers, teachers, firemen and even the police. The French tend to look on with sympathy or at least with a kind of resigned understanding.

Fair enough? Bear in mind that these are the same onlookers who deplore the gap between “ordinary people” and the so-called “political class”. The politicians, so the argument runs, are insulated from everyday reality by the perks of seemingly permanent office and are deaf to all but the loudest appeals. Hence the need to demonstrate in the streets. Family doctors, for example, this week grabbed an increase in their modest fees for consultations and home visits, but only after going on strike, demonstrating in the street and, last week, having a bust-up with riot police that was much-photographed.

Yet the argument is counterproductive. When street protests, mainly on behalf of a bloated public sector, become a negotiating tactic of first rather than last resort, politicians have less chance to listen to those ordinary people in the first place. Moreover, the argument is pernicious: the ritual of the street demonstration becomes a kind of blackmail, letting special-interest groups distort government behaviour. Hence the abandonment in the mid-1990s of public-sector reforms proposed by the then prime minister, Alain Juppé. Hence, too, the official deference shown latterly by Mr Jospin's government to José Bové, the farmer who became a hero for trashing a McDonald's, and to other foes of globalisation, even though France prospers in part because it is the world's sixth-biggest trader. Indeed, when the pro-globalisation World Economic Forum met earlier this year in New York, twice as many French bigwigs rushed off to pay homage at the rival anti-globalisation conference in Brazil.

Mob rule or the people's voice?

Were the marchers of May 2002, then, just another special-interest group or selfish lobby? Clearly not. For one thing, they were so many, from both left and right, from all classes and from all parts of France. For another, they demonstrated movingly for a united France, not a divided one. And lastly, given the record vote on May 5th for Mr Chirac and the humbling of Mr Le Pen, they surely stood for a majority view, not a minority one.

Yet those who are eager to place them alongside the *soixante-huitards* in the political pantheon should bide their time. After all, Mr Le Pen's National Front may yet do well enough this weekend to proceed to the second round in roughly half of France's 577 constituencies. Moreover, whatever the results, a *Le Monde* poll three weeks after the May Day marches found that 28% of the French agree, in whole or in part, with Mr Le Pen's ideas and only 49% entirely oppose them; three years ago, the comparable figures were 11% and 63%. In other words, do not celebrate too soon. The gap between the politically-correct political class and many of their voters still yawns, however raucous and vibrant the demonstrations on the streets.

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Drugs

It's all in the price

Jun 6th 2002
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The street price of illegal drugs in Britain has never been lower. The message should be clear—prohibition has failed

Get article background

IF THE government is looking for evidence about how it is faring in the battle to stop illegal drugs flooding Britain's streets, it need look no further than what is happening to prices. When Home Office officials and police chiefs meet next month for crisis talks about the exploding use of crack cocaine, they will have to confront the fact that the drugs they most fear have never been cheaper or more plentiful.

The threat of crack, the most dangerous and unpredictable of illegal drugs, has been fuelled by the easy availability of cocaine. During the past ten years, the street prices of both hard and soft drugs have fallen sharply. Cocaine and heroin have declined by nearly a third, while ecstasy has dropped by more than half (see chart).

In real terms, the figures, compiled by the National Criminal Intelligence Service (NCIS), represent an even sharper fall. While whisky and beer prices have doubled and cigarettes almost tripled in price over the decade, illegal drugs are now often cheaper than a night out in a pub. The cost of LSD, a hallucinogenic drug, is less than a packet of cigarettes.

These figures confirm that the increasing resources employed to disrupt the illegal drugs trade are having little impact. Over the past five years, heroin seizures have more than doubled and cocaine seizures have increased five-fold. But Customs and Excise officials accept that they are intercepting only a fraction, probably less than 10%, of the drugs coming into the country. Terry Byrne, director of law enforcement at Customs and Excise, acknowledges that the street prices of drugs have never been lower. He also admits there is no evidence that the efforts of his and other agencies are “reducing availability or increasing the price of illegal drugs”.

Neither Customs and Excise nor NCIS are willing to discuss the forces driving the market. But Home Office officials say that events in Afghanistan have had a key role in boosting heroin supply. The increasing use of cocaine appears linked to the West Indies. Large amounts are being brought in by West Indian “drug mules”, often women who agree to swallow packets of cocaine and smuggle them in at high risk for a couple of thousand dollars.

Given that the streets are awash and that buying of both hard and soft drugs has never been easier, the government's national anti-drugs strategy set out four years ago looks increasingly like a work of fantasy. One of the government's main targets, to reduce the availability of Class A drugs by 25% by 2005 and by 50% by 2008, is so far adrift that an increase in availability is more likely to be recorded than a fall.

The Association of Chief Police Officers says bleakly that if existing drugs policy is to be judged “by measurable reductions of people who use drugs and the amount of crime committed to get money to buy

drugs”, then it is failing.

The Home Affairs select committee said in a report, published last month, that the government should concentrate its efforts in treating the estimated 250,000 hard-core addicts rather than pursuing criminal penalties. It called for “safe injecting houses” for addicts to be set up together with a large-scale trial of heroin prescribing. It also wants ecstasy to be downgraded to a Class B drug.

Predictably, this is all too radical for the government. But the home secretary, David Blunkett, has moved a long way from the policy of his predecessor who, two years ago, dismissed a demand by a distinguished committee of medical, legal, police and drug specialists for reform of Britain's archaic drug laws. A revised national drugs strategy is to be published next month which is likely to back many of the committee's recommendations. Mr Blunkett has already announced that he plans to downgrade cannabis to a Class C drug, which means the penalties for possession becoming nominal. He is also sympathetic to strictly monitored trials of heroin prescribing. The new strategy is likely to focus on treatment rather than enforcement.

A new approach is badly needed but whether this shift towards treatment will work is uncertain. One problem is cost. Prescribing heroin to hard-core addicts could cost more than £250m ($363m) a year. But Transform, a pressure group in favour of legalisation, claims that the current regime costs at least £10 billion a year, if the burden of dealing with drug-related crime and prisons are included in the calculation. Almost two-thirds of those who are arrested test positive for drugs. Doing nothing may be politically safe but it is not a cheap option.

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Drugs in Lambeth

Little Amsterdam

Jun 6th 2002
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Cannabis isn't legal in Lambeth. Perhaps that's the problem

NOT all Her Majesty's subjects were celebrating during her jubilee parade: a few industrious souls were at work. “Skunk weed, man?”, inquires a vendor on Landor Road in Lambeth. “Marijuana, baby?”, asks a woman outside Brixton tube. “Skunk weed?”, suggest several men on Coldharbour Lane, where a familiar smell mingles with the noise of a Brixton street party. (“Respec' to the queen; respec' to Mr Eriksson”, says the MC.)

The number and brazenness of drug-dealers in Lambeth is, according to some, the result of a policing experiment that began in the borough last July (and which has survived the departure of its former and flamboyant police commander, who was removed after allegations by a former boyfriend that he dabbled with the weed himself). Contrary to local superstition, possession of cannabis is still illegal, but people caught with small amounts can be punished with confiscation and a warning, rather than arrest.

The idea is to cut out the cumbersome bureaucracy of arrests—liberating officers to deal with serious criminals, including dealers—and to help endear the police to locals. Recent research for the Joseph Rowntree Foundation, a think-tank, suggests that many arrests for cannabis possession derive from the police stopping and searching people suspected of more serious crimes, which they are rarely found to have committed. A bit of resentment is understandable.

An evaluation of the Lambeth trial by the Metropolitan police revealed that it has indeed saved some man-hours. Perhaps as a result—or perhaps because there's more of it about—a greater number of cannabis offences have been recorded. Street crime in Lambeth has recently declined, but that has more to do with a separate anti-mugging initiative.

Anecdotally, though, things have got worse. Drug-dealers and users have been attracted to the area, many locals say, bringing other types of crime with them—even though, as in other parts of the country, the police were already fairly relaxed about cannabis possession before the experiment. “If people want to score”, says one disgruntled resident, “they now come to Brixton”. These days, says a denizen of the tough Stockwell Park estate, the dealers are “cocking a snoop” at the police.

Kate Hoey, the local MP, is fuming. So is Dr Claire Gerada, head of drugs training at the Royal College of General Practitioners and a Lambeth resident, who says that the cannabis now readily available to disadvantaged local children is much more debilitating than the kind policymakers may have experimented with in the 1970s. Too many kids, she says, now think that anything goes. Opinion polls suggest the Lambeth pilot is less popular among ethnic minorities and parents than others (it is also unloved by some ordinary police officers).

Opponents of liberalisation have inferred that it might, after all, be preferable at least to pretend to enforce what is an unenforceable law. But it might be better still to abandon it altogether: as well as highlighting the problems with differential policing, Lambeth suggests that as long as supplying drugs remains criminal, greater tolerance of possession may have limited benefits. Alas, this sort of fudge may give sensible reform a bad name.

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Cooking

Ready, steady, eat

Jun 6th 2002
From The Economist print edition

The more cooking there is on television, the less people cook

Read those lips

GIVEN the regularity with which that most celebrated of chefs, Nigella Lawson, is shown bearing down on some delicious bouchée, lips parted, one can only assume that television executives believe viewers to be in mortal danger of forgetting the link between food and sex. But the drive to turn cooking into pornography is working all too well. As porn is to sex, so the likes of Ms Lawson seem to be to cooking. The more people watch, the less they do it.

According to a regular survey carried out by Taylor Nelson Sofres, a market research firm, the amount of time that people spend preparing food has dropped sharply over the past two decades from one hour a day to an average of 20 minutes. Which, given the proliferation of television programmes, books and newspaper supplements on cooking, seems odd.

What is to blame? Shortage of time is the usual suspect, though presumably people could be cooking their own “Tagliatelle with Chicken from the Venetian Ghetto” instead of watching Ms Lawson knock up (and avidly devour) her own. Still, some combination of busy-ness and family disintegration has led to the growth of the ready-meal market, which is probably the immediate culprit.

Ready-meals first emerged in Britain in the early 1980s and the market is still growing fast: Geest, a British food supplier, estimates that the ready-meal market was worth £1.1 billion ($1.6 billion) in 2001, up 16% on 2000. As the business grows, so product quality and variety improves, so more people eat them.

Predictably, this gastronomic decline is culturally divisive. According to a recent Reuters study, ready-meals and other “meal solutions” are most popular in America, Britain and Sweden, because of the prevalence of single-person households and working women in those countries. They are slightly less popular in France, Germany and the Netherlands. The Spanish and Italians barely acknowledge their existence.

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Scots in government

Jocks rule, is that OK?

Jun 6th 2002 | EDINBURGH
From The Economist print edition

The government is full of Scots. Oddly, this may turn out to be good news for England's regions

FAMOUSLY protective of his family's privacy, Tony Blair is also reticent about his own upbringing. He never, for example, makes anything of his Scottish roots: he was born in Edinburgh of Glaswegian parents and went to Fettes College, Scotland's poshest school. That may be because if he did, it would draw unwelcome attention to the fact that the government is already top-heavy with Scots. As yet, this does not seem to bother English voters unduly, but left untended, it has the potential to create trouble.

The 55 Scottish Labour MPs are only 13% of Labour's parliamentarians, yet they fill nearly a quarter of the seats available to elected politicians in Mr Blair's cabinet. Apart from Helen Liddell, the Scottish secretary, there is Gordon Brown (chancellor), Alistair Darling (transport), Robin Cook (leader of the House of Commons) and John Reid (Northern Ireland). That's not all. In proportion to their parliamentary strength, the Scots take a bigger share of governing Britain at junior ministerial level too than do English and Welsh MPs (see table).

Who runs whom?

Constituency	Labour MPs	Cabinet ministers	Junior ministers	% of MPs with government post
England	322	15	54	21
Scotland	55	5	10	27
Wales	34	1	4	15
Total	411	21	68	22

Source: House of Commons Excludes Speaker and members of the House of Lords

This dominance is all the more striking given that a lot of ministerial posts—in education, health, the Home Office—are in effect off limits to Scottish MPs because they concern only English matters. Add in such figures as Lord MacDonald of Tradeston, who runs the Cabinet Office (now in effect the prime minister's department) and Lord Irvine of Lairg, the Lord Chancellor, and the extent of Scottish political power looks impressive indeed.

It is not hard to explain. During the 18 years of Tory rule, while Labour in England lurched towards looniness, the Scottish Labour Party remained solidly sensible. Through the trade unions and councils, it retained localised power which the Scottish Tories, because they had fewer votes and seats than Labour, had to learn to live with and accommodate.

The influence of the Scottish church, and Scotland's distinct education and legal systems has also been strong, producing people (in all parties) with political passion and talent. Labour, because it is the biggest party in Scotland, is the main beneficiary. Unlike Welsh politics, which is bedevilled by parochial rivalries, Scotland has the political infrastructure to enable seriously ambitious politicians such as Mr Brown to rise to the top. He, in turn, has recruited followers and diligently, at times even ruthlessly, promoted their careers within government.

Does this matter? Apart from some minor transgressions, the Scots ministers have been a competent bunch. After five years, Mr Brown's record as chancellor can be criticised, but he stands far above any conceivable rival for the job. And, after all, both Margaret Thatcher's and John Major's governments also had plenty of kilts round the cabinet table.

But that was before devolution. Now the Scottish Parliament and not Westminster is responsible for Scottish domestic affairs such as education and health. Scottish interests at Westminster are limited to taxation and economic management, welfare, defence and foreign affairs.

This reduced political engagement is being partly dealt with by cutting the number of Scottish MPs from 72 to 57 at the next election. That should trim the Labour contingent by about ten. Meanwhile it is forcing Messrs Brown, Darling and Reid into undignified scrambling for new seats. But it still leaves Scotland with a Scottish secretary in the cabinet, the need for which looks increasingly hard to justify.

Even if Mr Blair does nothing to correct that anomaly, a more important and growing problem is that of public spending. It has long rankled with English MPs, especially in the north, that the Scots get a disproportionate amount of money from the Treasury. In 2000-01, about £440 more per head (excluding welfare and farm spending) was spent on Scottish public services than on those in the north-east of England.

Now that the government is offering elected assemblies to the English regions, these spending disparities are poised to become a big political issue. Ministers know this and steps are being taken in this year's spending review, the results of which will be announced later this summer, to redress some imbalances.

If Mr Brown is still serious about succeeding Mr Blair as prime minister, which is hardly in doubt, he cannot afford to do nothing. With a reduced Scottish power base, he will have to win support in Labour's English heartlands, particularly in the north of England. Money will be the best way of doing it. Despite his stellar post-budget opinion poll ratings, these days, not even a figure as substantial as Mr Brown can run the risk of being seen to be too Scottish.

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Music

Brassed off

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Brass bands struggle to survive as the industries that spawned them die

“BRASS bands are all very well in their place—outdoors and several miles away,” Sir Thomas Beecham once sniped. The sound of a band at full throttle is still as distinctive as ever, but these days it is seldom heard. In 1900, when the brass-band craze reached its height, there were between 30,000 and 40,000 amateur brass bands in Britain. Today there are around 1,500.

The Point of Ayr Band from North Wales came third in the 2001 world finals. But this year it withdrew from the British championships. The band was formed by workers at the local colliery; miners contributed a penny a week from their wage packets. The colliery closed in 1996. Sue Hughes, the band's former manager, says money troubles had become so pressing that playing was no longer a pleasure.

Competing leisure activities account for some closures. But many bands' fortunes have been closely linked with those of Britain's urban working class. The movement first gathered steam in the 1840s. Valve instruments were cheap, easy to learn and macho enough to appeal to workers in the new industrial towns. Trevor Herbert, professor of music at the Open University, says that canny instrument manufacturers found a willing audience among employers, who saw music as an improving hobby and a distraction from more militant pursuits.

Industrial decline has hit bands hard. There are now 10,000 coal miners in Britain, compared with a million at the industry's height and 200,000 in 1975. Generations of the same family often played in their local band; now they disperse in search of jobs. Service industries, such as the call-centres in which many now work, seldom foster the same community spirit.

The Salvation Army's bands have done better than most; there are 468 in Britain today. But only the most famous or frugal of the big secular bands get by on concert fees and prize money, and most have had to look for funding beyond their local town. Some have succeeded. One, the Cory band from South Wales, is sponsored by Buy As You View, a pay-TV company. Another, the old Hammond Sauce Works band, was adopted by the Yorkshire Building Society in 1993. It has won five out of the last six European championships.

Others have been less lucky. Hayley Granger of the British Federation of Brass Bands admits that the movement's old-fashioned image scares off potential sponsors. But the notion of players with a trumpet in one hand and a pint in the other is largely unfounded. The fiercely-fought contests encourage professionalism and virtuosity; about 550 bands still compete in several grades, which players compare to football leagues. Many hold workshops and push hard for new recruits. Some run youth bands, about 40 of which take part in their own annual championships. Peter Bassano, the head of brass at the Royal College of Music, says that nearly all the trumpet, trombone and tuba players in the major orchestras started in local bands. Britain's musical life would be poorer without them.

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Anti-globalisation

Reclaim the streets

Jun 6th 2002
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International capitalism meets its match in north London

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ACCORDING to its many detractors, globalisation generally involves rich multinational companies colonising the world and steamrollering indigenous cultures; all too often, resistance to the god of profit is futile. But not, it seems, in north London, where the little people have singed the beard of international capital.

Well, sort of. Starbucks, a coffee behemoth, and one of the great satans for the anti-globalisers, wants to extend its empire into Primrose Hill. Its plans were met by all the usual objections about third-world labour practices and unfair competition, and another, perhaps even more inspiring concern: taste.

Primrose Hill (or “the village” as residents like to call it) is a preternaturally serene community in north London. Its tranquillity is only disturbed when photographers are thumped by one of the less genteel of the many celebrities who call it home. Its quaint high street contains a fish and chip shop and a bookmaker that, nestled among their chic neighbours, look rather like historical exhibits. At the weekend its numerous independent cafés and restaurants are crammed with locals, and visitors hoping to see somebody famous.

So when the prospect of a vulgar multinational setting up shop was mooted, the locals mobilised. Fortunately, Starbucks was obliged to make a planning application to Camden council. Also fortunately, Patrick Caulfield (an artist), Neneh Cherry (a singer), Alan Bennett (a writer) and a café-full of other celebrities were among the 1,387 folk to register their objections. “We should be fostering genuine shops, not ones for tourists”, says Mr Bennett.

Perhaps the villagers learned from the experience of their neighbours in Hampstead, a similarly rarefied community that recently went to war with McDonalds. That leviathan managed to occupy only a small and discreet site in Hampstead; Starbucks also established a toe-hold there. But it won't, for the moment at least, be lowering the tone in Primrose Hill. Cliff Burrows, the company's local managing director, concedes that it wouldn't be appropriate to open up in the current climate.

Globalisation, however, could yet bite back: Starbucks hasn't withdrawn its planning application, and may just be waiting for the villagers to calm down a bit. For the moment, though, fame, taste and some old-fashioned protectionism seem to have kept it at bay.

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Bagehot

In a spin

Jun 6th 2002
From The Economist print edition

The government says it wants a different relationship with the media. Some hope

FOR much of its life, the government has enjoyed a remarkably harmonious relationship with the press. While some traditionally Tory-supporting newspapers, such as the *Sun* and the *Express*, overtly ditched their previous allegiance, others, less flighty, have nonetheless offered grudging respect. Electoral dominance and competent economic management have played their part. But so too, according to New Labour lore, has clever handling of the media—a core competence that has provided a foundation for other successes. Which is why the government's current travails have left it feeling both angry and a little scared.

Well before Stephen Byers had succumbed to what everyone outside government had assumed to be the inevitable, the alarm bells had been ringing in Downing Street. Indeed, the fight to save first Jo Moore, Mr Byers's disgraced political adviser, and then the transport secretary himself, was all the more determined because the government already considered itself locked in a struggle for survival against the media. Throwing a bleeding body over the side would only increase the frenzy of the circling sharks. As soon as the jubilee was done with and the corpse of Mr Byers digested, it would be somebody else's turn.

As well as the protracted hunting down of Mr Byers, the government has had to contend with a stream of stories about the surprising people the Labour Party has been happy to solicit money from. While charges of actual impropriety have never quite stuck, the effect has been debilitating, eroding public trust in Tony Blair personally and making ministers appear shifty.

To older hands, who recall the infinitely more brutal treatment routinely dished out by the press to the Wilson and Callaghan administrations, this is no more than a return to business as usual. But for New Labour, unaccustomed to serious opposition from any quarter, and with the memory fresh of how both Neil Kinnock and then John Major were destroyed by press ridicule, it is genuinely alarming. Worse still, the tactics that were developed to deal precisely with threats of this kind—the ceaseless courtship of the owners and editors of newspapers, the calculated pandering to the BBC and, above all, the sophisticated use of spin with favoured journalists—are no longer working.

The government has its own analysis of what has gone wrong. Both Alastair Campbell, the prime minister's chief of communications and strategy, and his one-time partner-in-crime, Peter Mandelson, have announced that spin has had its day. While vital for the politics of opposition (which is all about responding to events), over-use of spin in government (which is all about delivery), they say solemnly, has led to cynicism. For this, Mr Campbell nobly accepts his share of the blame.

Questions, always questions

However, Mr Campbell, a former political editor, has concluded that his erstwhile colleagues, the members of the so-called parliamentary lobby, a select (but not very exclusive) group of journalists who roll up twice a day to be briefed by someone called the PMOS (the prime minister's official spokesman), are also at fault. Mr Campbell, who until last year used to give these briefings himself, has noted with disapproval that when a story breaks that is embarrassing to the government, the lobby journalists become over-excited and ask the PMOS a great many questions. Even when the PMOS, these days a career civil servant who is obliged to play with the straightest of bats, has answered as best he can, they persist, trying to make him say more than he wishes or even, perish the thought, to catch him out in some way. Mr Campbell regrets this. He believes that by hunting as a pack, the lobby distorts the news. Most of all, he deplores what he sees as its passion for trivia and tittle-tattle.

Mr Campbell has therefore set about jamming the lobby's jaws. Already, he has announced that the morning briefings will be open to any journalist, including those from foreign media, who cares to turn up. The result is likely to be a much more easily stage-managed conventional press conference. He has also set up a committee to propose other changes, among which are rumoured to be “themed briefings” on policy issues and the setting of strict guidelines for the number of questions any member of the lobby can ask.

The government's anxiety is understandable. But whether these or any other measures it chooses to take will result in the more responsible press it hopes for is less clear. It has, possibly rashly, asked to be judged on its record of improving the quality of key public services. But even with a measure of success, it must know that the stories that will still predominate are more likely to be about imploding casualty departments and shoddy track maintenance than barely perceptible amelioration. Curtailing spin, and putting dour and competent folk such as Alistair Darling in charge of critical ministries, may limit damage of one kind, but it will also leave a news vacuum. Newsmen, as Mr Campbell knows only too well, abhor a vacuum.

Yet there is a further, shall we say, complication. While the stories about party funding must eventually abate, if only through sheer fatigue, that will not mean an end to embarrassment, as the fall-out from last week's reshuffle proved yet again. Michael Wills, an obscure chum of Gordon Brown's, was first sacked from his lowly ministerial job and then, 48 hours later, appointed to another. The tension between the chancellor and the prime minister informs nearly everything that happens within this government. In the strictest sense, stories about the consequences of their troubled relationship should be counted as political gossip or tittle-tattle; they will never be the subject of one of Mr Campbell's “themed” press conferences. Furthermore, the differences between the two men have almost nothing to do with policy. In this struggle between two factions, the weapon of choice is spin and the battlefield the newspapers. Is that the fault of the trivialising press?

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Vivendi Universal

Messier's mess

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From The Economist print edition

Reuters

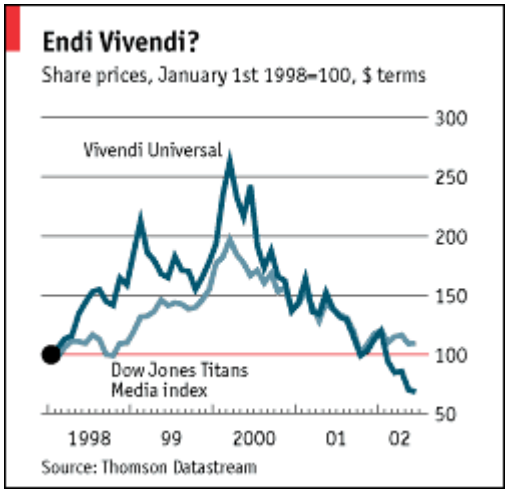
The financial troubles of Vivendi Universal are far worse than they appear. Can the global media group escape without being broken up?

Get article background

IT IS no secret that Vivendi Universal, a once high-flying media and telecoms group based in France, is facing a serious financial crunch. Last week, at a tense meeting in New York, its board debated how to tackle the firm's *euro*19 billion ($17.9 billion) of debts and reverse the slide in a share price that has fallen from a peak of *euro*141 in March 2000 to only around *euro*30 now. Successive credit downgrades have reduced Vivendi's debt virtually to junk status.

Almost the only good news for Vivendi in recent weeks was the announcement on May 30th by Standard & Poor's (S&P), a credit-rating agency, that it no longer fears that a further downgrade could trigger a catastrophic slide towards bankruptcy. That came after Vivendi managed to persuade its banks to delete clauses from its credit agreements that allow lenders to demand immediate repayment if the rating falls below an agreed level.

Despite that slight relief, Jean-Marie Messier, Vivendi's chairman and chief executive, is fighting for his job. He has considered selling a big part of Vivendi's 63%-owned environmental arm, along with several other businesses, to raise much-needed cash for his media and telecoms arms and stabilise Vivendi's finances.



However, the group's financial position appears to be much worse than is currently believed by most analysts. As the analysis below will show, Vivendi's profits are far weaker than is generally understood, and it will struggle to avoid being crushed by a debt mountain that already threatens the dividend. Vivendi chooses to highlight a number that gives a misleading impression of its profits, thus grossly flattering a key financial ratio that underpins its credit rating. Moreover, despite a *euro*12.6 billion writedown in the value of firms it has acquired in the past two years, Vivendi still puts optimistic values on several assets, especially its near-bankrupt pay-TV business. Vivendi could even face the prospect of a break-up that would pit its shareholders against its bankers.

From sewerage to Seagram

A look at Vivendi's recent history helps to shed light on its byzantine finances. In the mid-1990s Mr Messier used a French water utility as the launching-pad for a series of deals to create a presence in the telecoms and media industries. In 2000 the original utility, called Vivendi Environnement, was partially floated, with Vivendi retaining majority ownership and control.

By then Mr Messier had built a global media operation. Using highly priced shares as an acquisition currency, he paid *euro*12.5 billion for control of Canal Plus, a pay-TV group, and spent *euro*32.6 billion to acquire Seagram, owner of Universal, one of the world's leading film and music brands. Integrated with Vivendi's existing telecoms and media businesses, this became the core of the new group.

Vivendi made a further flurry of deals last year and has continued to mutate in recent months. One result of this activity is that the group is highly complex. Its recently published 2001 accounts and regulatory filings have provided perhaps the first set of numbers that make possible a proper analysis of its financial health.

The perils of ebitda

At the centre of this analysis is a measure known as ebitda (earnings before interest, tax, depreciation and amortisation). For most investors, ebitda is synonymous with cashflow, a view that few companies discourage. But ebitda is an inadequate guide to cashflow because it takes no account of a firm's capital spending and gives no indication of how much profit is actually turned into cash—as opposed to, say, remaining tied up as receivables.

Despite its shortcomings, ebitda now plays a central role in the work of analysts and rating agencies. S&P, for example, uses the ratio of ebitda to a company's debt as one of the principal factors in determining its ratings. These ratings in turn affect what interest rate the company pays on its debt, and also how much capital markets and banks are willing to lend to it.

Vivendi and other big groups are enthusiastic users of ebitda because it gives a flattering picture of performance. Indeed, Vivendi defends its presentation. “We are transparent enough that the market and analysts can make their calculations the way they want to,” says Guillaume Hannezo, the chief financial officer. The company even bases its bonus schemes for top management on ebitda. This explains why Mr Messier's total pay last year was an impressive *euro*5.12m, despite the fact that Vivendi announced France's biggest-ever corporate loss of *euro*13.6 billion.

In Vivendi's case there are special reasons why the ebitda number is misleading. The main one is the group's practice of fully consolidating the profits of some companies in which it is a minority shareholder. For instance, Vivendi includes in its profits all of the ebitda of Cegetel, a telecoms group that owns 80% of SFR, France's second-biggest mobile operator. As Vivendi owns only 44% of Cegetel, its true share of SFR's ebitda ought to be 35%. Vivendi justifies counting all of SFR's ebitda because it has board and management control of Cegetel.

The effect on its stated ebitda is dramatic (see table 1). Last year, Vivendi reported ebitda of *euro*5.04 billion, of which telecoms accounted for *euro*2.31 billion. Give Vivendi only 35% of SFR's earnings, however, and that telecoms figure falls to *euro*807m. Vivendi's true ebitda was therefore only around *euro*3.5 billion, and its debt/ebitda ratio was 5.1, far worse than the 3.8 under Vivendi's own accounting.

New view 1

Year to December 31st 2001, bn

	Vivendi's view	Alternative view
Ebitda	5.0	
of which telecoms	2.3	
apportioned at 35%		0.8
Adjusted ebitda		3.5
Debt	19.1	19.1
Debt adjusted for telecoms*		17.9
Debt/ebitda ratio	**3.8**	**5.1**

*By apportioning the 1.8 billion of Vivendi debt that belongs in Cegetel

Sources: Company accounts; *The Economist*

Only near-bankrupt companies show ratios as large as 5, so *The Economist* asked S&P why it accepts Vivendi's full consolidation of Cegetel's earnings. The rating agency says it is assuming that later this year Vivendi will buy out some of the other owners, taking greater control of Cegetel's cashflow for itself. S&P admits that its overall rating on Vivendi is qualitative rather than purely quantitative.

There is another way to

demonstrate the weakness of ebitda as a tool for assessing Vivendi. Last year the company says it produced free cashflow (ie, ebitda minus capital expenditure and holding-company costs, adjusted for earnings not turned into cash) of *euro*2 billion. Of that, *euro*1.5 billion came from the telecoms businesses (see table 2). However, free cashflow based on Vivendi's actual stakes in its various holdings was a far more modest *euro*800m, barely enough to cover an estimated *euro*700m of interest charges on Vivendi's debts, let alone the *euro*1.2 billion dividend and related taxes it paid in 2001.

Not so free 2

Year to December 31st 2001, bn

Vivendi's stated free cashflow	2.0
Deduct telecoms cashflow	1.5
Add adjusted telecoms contribution after 3G licence costs	0.3
Total adjusted cashflow	0.8

Sources: Company accounts; *The Economist*

This raises a question: where did Vivendi find the money for its dividend? The answer lies deep in its accounts. For the past two years, Vivendi has raided special reserves tucked away in the balance sheet of its holding company. Once such reserves have been used up, the company must either cut its dividend, because it has nothing left to distribute, or it must bring up sufficient earnings from its subsidiaries to cover a payment.

It does not help Vivendi that it is subject to a special tax levied on French firms that distribute dividends out of overseas profits or special reserves. During 2001, this levy cost the company *euro*213m. This year Vivendi will have to stump up another *euro*337m. If this tax persists, Mr Hannezo says that Vivendi intends to reduce the dividend. That prospect is unlikely to reassure investors.

Asset inflation

Vivendi's gigantic loss for last year included a *euro*12.6 billion writedown in the value of assets bought during its acquisition binge. By far the biggest writedown was a *euro*6 billion charge against the value of Canal Plus, the group's pay-TV operation.

Only two years ago Vivendi paid an astonishing *euro*12.5 billion to buy the 51% of Canal Plus that it did not already own. At that time, Canal Plus was loss-making and had around *euro*2.8 billion of debt, so it seems Vivendi paid a frothy price to begin with. Since then, conditions for pay-TV companies in Europe have become much tougher; several, including KirchPayTV and ITV Digital, have gone bust.

The writedown of Canal Plus leaves it worth *euro*6.5 billion on Vivendi's books. But is it really worth that much? Last year Canal Plus made an operating loss of *euro*374m and drained *euro*500m of cash from Vivendi. Most of the problem is attributable to its Telepiu subsidiary in Italy. Were it not for the support of its parent, Canal Plus would probably have gone bust. It is possible that Vivendi's auditors will ask for a further writedown when the group closes its half-year books at the end of June.

To maintain Vivendi's credibility in financial markets Mr Messier has said that he will significantly reduce its debts, bringing its debt/ebitda ratio to 3 by the end of this year. He has also said that he expects ebitda to reach *euro*6 billion, which implies a total debt of *euro*18 billion.

Can Vivendi's targets be taken on trust? One striking episode suggests that investors should be sceptical. On September 25th last year, Vivendi announced that it intended to cancel around 3% of its share capital by purchasing 33m shares for cash in the open market. The implication was that it had plenty of financial slack and thought its shares were undervalued.

However, the 33m shares were never cancelled as promised. In December Vivendi used 32m shares as part-payment for the entertainment businesses of USA Networks, an American company, saying these were the shares that were to have been cancelled. But in early January, Vivendi changed tack again, dumping 55m previously purchased shares back on to the stockmarket and raising *euro*3.25 billion of cash. The share dealings indicate an urgent need to raise cash, an observation supported by the fact that, just before the end of last year, Vivendi abruptly sold 9% of its stake in Vivendi Environnement, bringing in *euro*1.2 billion.

Vivendi further surprised investors in March by properly disclosing for the first time commitments it had made to buy its own shares at prices well above the current level. Mr Hannezo confirms that Vivendi is

using cash each month to buy out these “put options”. The options carry a potential financial risk of *euro*600m.

Liabilities such as these, as well as pressure from credit-rating agencies, have led to an overhaul of Vivendi's balance sheet. In recent months the company has raced to reduce its reliance on short-term debt, particularly commercial paper that it could no longer place in the market. It has renegotiated or extended its credit lines with its banks, especially those with Société Générale, its main lender. In March Vivendi raised a new *euro*3 billion medium-term facility, and in April it sold part of its publishing business to raise a further *euro*1 billion.

Despite all this activity, Mr Hannezo says that Vivendi's debt was little changed at the end of May, at around *euro*19 billion. However, says S&P, the company's efforts mean that the likelihood of a short-term liquidity squeeze has diminished. S&P's latest estimate is that Vivendi has *euro*2 billion-3 billion of debt to repay in the rest of this year, and a similar sum in 2003.

Nonetheless, most analysts appear too sanguine about Vivendi's ability to wriggle its way to safety, in part because they accept its flattering ebitda numbers. Mr Messier and his team might yet slip up. To see how, first consider S&P's assumption that Vivendi will gradually take full ownership of Cegetel, perhaps beginning later this year with the purchase of a 26% stake held by British Telecom. S&P describes this outcome as a key “rating support”.

But BT is unlikely to accept Vivendi's sagging shares even in partial payment. That means that Vivendi will have to take on yet more debt. It is difficult to put an exact price on BT's stake in Cegetel, but around *euro*4 billion is plausible. Because it already fully consolidates Cegetel, Vivendi will get no boost to its earnings.

Other, more extreme scenarios contain similar traps. If Vivendi were forced into a strategic retreat from telecoms by selling its stake in Cegetel, the *euro*6 billion or so it might raise would have to be used to pay back the *euro*16 billion of debt that is now in the central holding company. That would leave a still formidable debt, with only the media assets to support it.

A further problem concerns Vivendi's 63% stake in Vivendi Environnement, currently worth *euro*7.2 billion. After the board meeting in New York on May 29th, Vivendi became uncharacteristically silent about its plans for this stake, having previously suggested that it might be sold. As *The Economist* went to press, there were rumours that Vivendi might soon announce its intention to reduce its holding, raising around *euro*2.3 billion, thereby losing control.

But Vivendi Environnement has troubles of its own. It has debts of *euro*16 billion and its share price has tumbled, from more than *euro*50 to below the *euro*34 level at which it was floated two years ago. Top managers want a capital increase to shore up the balance sheet and have been openly critical of Mr Messier, who in the past has failed to inform them before talking to journalists about his plans.

All of which suggests that there is no easy way out for Vivendi Universal. On one side, it must reduce its debts and it may have to write down the value of its overvalued assets further. On the other, it faces having to cut dividends and borrow more to buy its way out of trouble. In the meantime, it remains worryingly dependent on the markets' continued acceptance of its dubious financial ratios.

Were investors to lose faith in the company's assumptions and numbers, its share price would come under renewed pressure. Simmering boardroom tensions would almost certainly boil over. Mr Messier might then learn a painful history lesson: it is one thing to build an empire, quite another to make it endure.

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Tyco's troubles

Taxing times

Jun 6th 2002 | NEW YORK
From The Economist print edition

The man behind Tyco's rise and fall returns to the realm of mortals

AP

Reflective Kozlowski

DENNIS KOZLOWSKI never quite basked in the worship Americans reserve for their most hallowed corporate gods. But by turning an obscure New England electronics maker called Tyco into a high-powered conglomerate, he did secure minor-deity status. Lately, Tyco's shareholders have discovered that Mr Kozlowski may, after all, be human—rather too human, as it turns out. On June 4th a string of management blunders drew to a fitting close with Mr Kozlowski's indictment on a grubby tax-evasion charge.

Robert Morgenthau, New York's district attorney, must still prove his case. But Tyco's board has not waited for the verdict. Mr Kozlowski has been booted out. His employment contract, says a company spokesman, is void. Once hailed as the next Jack Welch, his reputation is in ruins.

In truth, Tyco never looked squeaky clean. In the months following Enron's collapse, Wall Street's short-sellers fed the market with rumours of hidden nasties in Tyco's books. Although nothing has been proved, the alleged scandal unearthed by Mr Morgenthau's office seems anti-climactically humdrum. The indictment alleges that Mr Kozlowski evaded $1m of New York state sales tax when buying fine art to decorate the walls of his Fifth Avenue apartment. According to Mr Morgenthau, Mr Kozlowski's second wife appears to have played a large hand in the purchases, which included a Monet and a Renoir. Mr Kozlowski, who was paid more than $30m last year, is alleged to have had these paintings shipped out of New York state (thus avoiding the sales tax), then covertly reimported. “Sad and pathetic,” is the verdict of one of Tyco's advisers.

Lawsuits probing what Tyco's board knew, and when, are sure to follow. That, however, seems the least of the company's worries. In January Mr Kozlowski said he would break Tyco into five pieces and sell or float the bits. In April he abandoned this plan, saying that he would keep the company intact but jettison its finance division, called CIT. At the same time, he surprised investors with poor earnings and a big writedown of Tyco's telecoms assets. All the bad news, he asserted, was now on the table.

John Fort, the Tyco board director (and chief executive from 1982 to 1992) who has been picked as the firm's interim boss, will now find investors more confused than ever. His first job is to convince the market that Tyco is not about to go bust. The company claims that it has enough cash to see it through to the end of this year. Next year, calculates Jeff Sprague of Salomon Smith Barney (which has at long last removed the company from its list of recommended stocks), Tyco must find $2.9 billion to pay off maturing debt, and a further $3.4 billion in 2004.

With Tyco still clinging to an investment-grade credit rating, Mr Fort ought to be able to raise the money he needs from the firm's bankers. But the terms are unlikely to be generous, after refinancing talks broke down in acrimony earlier this year. Such is the market's scepticism, however, that Tyco is wisely sticking with its plan to settle the liquidity fears as quickly as possible. That means floating CIT, which the company says it will do via an initial public offering (IPO) by the end of this month.

Unfortunately, all is not well with this plan. Tyco had been hoping to collect $6.5 billion from the CIT sale. Last month, however, news leaked that one of the IPO arrangers, Lehman Brothers, had offered $5 billion for a private sale, which made the suggested IPO price look too high. Tyco's latest problems are likely to drive CIT's price down further.

In fairness, Mr Kozlowski does not deserve to shoulder all the blame for Tyco's tarnished image. As a manager, history may judge him as a great acquirer, but precious little else. As a man, the alleged risks he took to avoid an 8.25% sales tax seem hard to understand, although those who hobnob with the super-rich may beg to differ. His biggest failing may be one that Mr Kozlowski himself was candid enough to admit: he had become a creature of his shareholders, and their obsession with short-term performance. That, he said, was what led him to the misjudged break-up plan. It may also explain why Tyco chased growth so aggressively for so long. Since shareholders have turned against this strategy, Tyco has become Wall Street's favourite whipping-boy.

And yet, despite all the bad news, Tyco's businesses still look reasonably solid. Its telecoms unit, which owns underseas fibre-optic cable, is in a mess—but at least it is still going, unlike most of its erstwhile competitors. Other businesses, such as health care and security systems, continue to spew cash. So far as it is possible to judge, Tyco's shortcomings do not appear as egregious as those of its former chief executive. There is a future for the company, if not a rosy one, without Mr Kozlowski.

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Pharmaceuticals

Courting trouble

Jun 6th 2002
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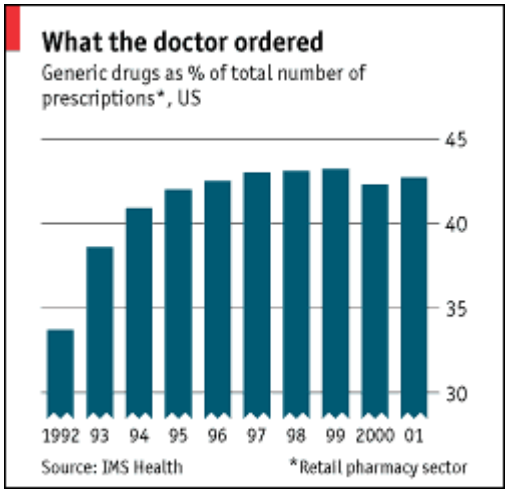
The industry faces a wave of litigation over drug prices



AMONG the side-effects of Taxol, a drug used to treat cancer, are hypersensitive American states. On June 4th, 29 state attorneys-general sued Bristol-Myers Squibb, the drug's manufacturer, for "fraudulently securing patents that had no legal validity" on the drug, thereby preventing generic competitors from entering the market and lowering prices for consumers.

This is not the first time that the attorneys-general have taken on the pharmaceutical industry. Last December, many of the same states launched a joint suit, also against Bristol-Myers Squibb, alleging that the firm had illegally spun out its patent protection, and raked in excessive profits, from another drug, BuSpar.

Earlier this year, Nevada and Montana separately sued a clutch of pharmaceutical companies for misrepresenting the "average wholesale price" (AWP) for their products—the price that government-financed health-insurance programmes, such as Medicare and Medicaid, use to reimburse doctors prescribing for their members. The states claim that drug companies have been buying physicians' favour by selling their products at a discount to the declared AWP, allowing the doctors to pocket the difference.

States are up in arms about drug prices because they are increasingly out of pocket from covering them. Ohio, which is leading the charge on Taxol, expects its drug bill to rise by 18% this year; in 2000 the state spent $878m, roughly a tenth of its Medicaid budget, on pharmaceuticals. As well as their solidarity in the courts, at least 35 states have banded together to form a task-force to look into drug-pricing issues.

They are not the only coalition fighting the drug makers. The Prescription Access Litigation project, a collection of 80 consumer and patient-advocacy groups, is suing a dozen firms, including Johnson & Johnson and Schering-Plough, for a variety of tactics that they say unfairly drive up drug costs.

Drug companies are well used to class-action suits over product liability. Grassroots litigation over product pricing, on the other hand, is a troublesome novelty. Ahaviah Glaser, director of the Prescription Access Litigation project, says that consumers are tired of waiting for legislators to make drugs more accessible, and have simply taken matters into their own hands.

With waves of blockbuster drugs going off patent, and problems over getting their successors to market, tough questions about prices are the last thing drug companies want. But they should not feel uniquely cursed. As Nancy Myers of Lehman Brothers points out, the lawyers who have drug makers in their sights have already challenged the tobacco and managed-care industries. Judging by the hard talk on both sides, peace is unlikely any time soon.

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Takeovers in Europe

Golden moments

Jun 6th 2002 | BRUSSELS
From The Economist print edition

A good week for deal-makers in the European Union

AFTER months of depression, this has been a good week for the European Union's liberalisers. The most important event was a long-awaited judgment from the European Court of Justice that will trammel the power of national governments to protect privatised companies from takeover bids. This ruling is expected to help break the liberalisation logjam by encouraging agreement on a much-delayed EU takeover directive.

The prospect of a new wave of corporate takeovers has been further enhanced by a change of tack by the EU's competition commissioner, Mario Monti, and by another court ruling. On June 4th Mr Monti said that in future the commission would be more sympathetic to the argument that a proposed takeover should be allowed if the cost savings that result can be shown to benefit consumers. Two days later, the European Court quashed a 1999 commission decision to block a merger between two British travel firms.

Over the past decade, Europe has seen a sharp increase in cross-border mergers, as the creation first of a single market and then of a single currency encouraged companies to become more international. In 1991, according to Morgan Stanley, there was $181 billion-worth of mergers in the EU; that figure peaked at $1.55 trillion during the stockmarket boom of 1999, but was still $704 billion in 2001.

But despite this decade-long surge in takeovers, there remain big obstacles to the free flow of capital around the EU. One of the biggest has been the habit of some national governments retaining “golden shares” in privatised companies—small parcels of shares that they can use to block proposed takeovers. The European Commission, the EU's executive, has long argued that golden shares are illegal impediments to the free movement of capital; now the European Court has largely agreed, by restricting the use of golden shares to a few special cases.

The court ruling could have a big impact on around 25 large European companies that are still protected by golden shares; indeed, the commission has already started proceedings against the British Airports Authority and Telefonica, a Spanish telecoms group. But this week's ruling should have implications well beyond the companies directly affected. It was largely the existence of golden shares that persuaded the European Parliament to block the EU's takeover directive last year. Opponents, particularly in Germany, argued that there could be no level playing-field for takeovers so long as golden shares were still legal. That line of argument has now been largely removed.

The commission will now feel encouraged to press ahead with a new version of its takeover directive. However, as Chris Huhne, a British Euro-MP, points out, there could still be political opposition to the directive, and in particular to its proposal to outlaw the allocation of different voting weights to different classes of shareholders. This threatens powerful businesses, including Sweden's Wallenberg family.

Of course, there have always been those who dispute the very idea that the commission might be a friend of big business. Corporate America was appalled when it blocked General Electric's proposed takeover of Honeywell last year. GE's supporters argue that the bureaucrats in Brussels placed too much weight on the interests of competitors, rather than those of consumers. Now Mr Monti—while still arguing that the commission got it right over GE—has signalled that the interests of consumers will count for more in future.

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Electricity in China

Power politics

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From The Economist print edition

Are China's electricity reforms doomed to fail?

IN APRIL, after a decade of political wrangling, China's government announced a blueprint for reforming its power sector. The plan's chief drawback is not that it said anything wrong, but that it said so little. “All eyes are now on the details,” says Scott Roberts, an analyst in Beijing for CERA, an American energy consultancy. And these are now being decided behind closed doors in various committees of the Communist Party, just as it prepares to change its leadership at a party congress later this year. The real political wrangling, in other words, has just begun.

Broadly, China, like many other countries that are reforming their electricity industries, is looking to Britain's deregulation in the 1980s as a model. Thus, China plans to split power generation from transmission, and to let four or five generators compete to supply the grid (which will itself be split along geographic lines). According to David Victor, director of energy research at Stanford University, the key variable that determines whether such a model works in the countries that he has studied is the institutional framework. Is the regulator genuinely independent? Is there rule of law and sanctity of contract? Are electricity companies properly and transparently governed? And so forth. Hence the worry that, if even California struggles to meet such conditions, China stands barely any chance of doing so.

Under China's brand of “socialism with Chinese characteristics”, the state dominates all big industries. But the power sector is easily the most politicised. After a decade of hesitant and arbitrary reforms, it is also among the most corrupt and inefficient. On top of the industry sits the State Power Corporation (SPC), China's largest state-owned company. It controls the grid, as well as about half of China's generating capacity. The other half is shared by a number of independent power producers, or IPPs. These tend to be independent in name only, since the SPC wields influence through ownership stakes or personnel links, even in the three IPPs that are listed on the Hong Kong stock exchange.

Crucially, the electricity industry is the traditional power base of Li Peng, a hardliner who used to be electricity minister and is now chairman of the National People's Congress. Mr Li is one of the top Communist leaders due to retire during the coming year, and is thus keen to keep the industry under his patronage. His son, Li Xiaopeng, not only heads Huaneng Power, the largest IPP, but is also a director of the SPC. His daughter is an executive at another power company. The Li family has been pitted against the market reformers in the party—including Zhu Rongji, China's prime minister, who is also due to step down. The Lis have not been able to block change, but they appear to have succeeded in watering down a more radical reform plan proposed last year.

For now, the result of all this politicking is a mess. Local and provincial officials have for years been building new plants for prestige (and with dubious licences), leaving large parts of China with a massive power glut. Nonetheless—and despite cost advantages in labour and fuel—Chinese consumers pay about 30% more for their electricity than do Americans.

In this environment, politically favoured companies do well, but those without connections suffer. The worst hit include a few hapless foreign investors, whom Beijing had invited to build plants in the early 1990s, when China faced an electricity shortage. Now, in the glut, provincial governments are reneging on their contracts with foreigners and refusing to pay. The finance director of the Chinese unit of AES, an American energy giant, says he first tried to sell the plants, but gave up and is now concentrating on chasing invoices. Britain's National Power, and units of Shell, Bechtel, El Paso and other energy multinationals, are equally desperate.

What, then, is the outlook for the reforms? The pessimists' case goes like this. Four or five power producers will supply electricity under some sort of “pooling” arrangement, but instead of arm's length

transactions and genuine competition, there will be political favouritism and venality. The industry will not become more efficient, and prices will not fall. As China's economy and its demand for electricity both grow, today's glut will eventually disappear. New investment in generating capacity will be needed, but foreign as well as private Chinese investment will shun the business. A shortage will ensue, choking China's development.

The optimists' case is that reformers will somehow gain the upper hand in the run-up to the coming leadership changes and push for more radical reforms, including a tough and independent regulator. In essence, this would require separating the industry from politics altogether. This really is an optimist's case.

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Digital photography

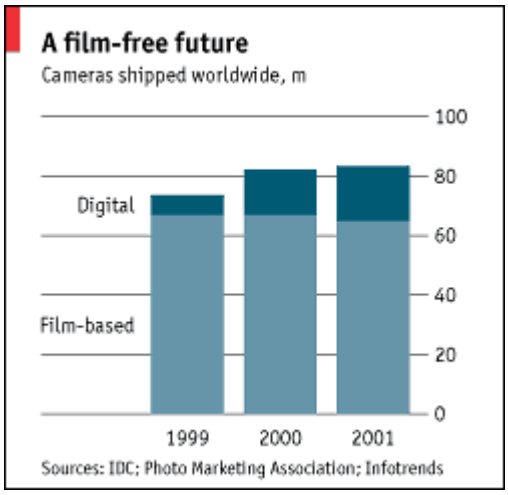
Prints and the revolution

Jun 6th 2002
From The Economist print edition

Digital cameras are popular, but making prints is still too hard

WHEN the Kodak Brownie was launched in 1900, its slogan was “you press the button and we do the rest”. Photographers no longer had to be amateur scientists adept at mixing chemicals in darkened rooms. Photography quickly became a mass-market phenomenon.

A century later, digital photography awaits a similar breakthrough. Digital cameras are increasingly popular—they accounted for around a quarter of worldwide camera sales last year (see chart)—but they are not for everybody. Getting the most out of a digital camera requires a PC to store, edit, distribute and print images. For many people, it is all too much hassle. According to Eastman Kodak, 80% of digital-camera owners still use film cameras more than half the time, and fewer than 20% of the 30 billion digital photos taken each year are ever printed out. Printing is simply too fiddly.



The industry is now trying to solve this problem, since prints are what make money. At the moment, that money goes mainly to the makers of paper and ink cartridges for colour printers, notably HP (formerly Hewlett-Packard). Indeed, the business is so lucrative that the European Union recently launched a probe into whether printer makers were illegally forcing consumers to buy their ink cartridges.

Making prints at home, however, is strictly for enthusiasts, since it involves transferring the images to a PC, manipulating them (to reduce “red-eye”, for example) and then printing them out. Far simpler are printers that plug directly into digital cameras, allowing prints to be made without a PC. But that raises the problem of long-term storage: where should pictures be stored once the camera's memory is full?

An alternative approach involves equipment in high-street photo stores that can produce prints from digital cameras on the spot. This is reassuringly similar to the current film-based way of doing things, and appeals particularly to companies, such as Kodak, that already have a vast retail network in place and are trying to shore up sales of film and paper. But again, long-term storage is the problem. One option is to transfer the images on to CDs, which can later be used to order reprints.

A third approach is to send images from a camera, via a PC, across the Internet to a photo finisher. The resulting prints are then sent back by post. Several such services exist, though none has really taken off. Without a fast Internet connection, uploading more than a handful of photographs simply takes too long.

It is unclear which of these approaches—home printing, high-street printing or online printing—will prevail. All three will probably co-exist, suggests Michelle Slaughter of Infotrends, a market-research firm. Home printing is fine for occasional prints, she notes, while high-street printing makes more sense for larger runs, such as holiday photos.

So far, HP and Kodak, the two companies best placed in digital photography, are hedging their bets. Both recently unveiled new digital cameras and software intended to simplify the sharing and printing of images. HP'S offering is called Instant Share and Kodak's EasyShare, but the idea is essentially the same. While out and about, users can tag selected images; when the camera is plugged into a PC, tagged images are automatically e-mailed to a list of recipients, posted on a web page, printed out on an

inkjet printer, or sent over the Internet to a photo finisher to be printed.

The big uncertainty, says Chris Chute of IDC, another market-research firm, is how a switch to digital will alter consumer behaviour. Sharing is easier with digital images, but printing is harder. Will digital users take more pictures, but print fewer of them? Might the PC or television screen become the dominant means of displaying images? Nobody knows.

As a result, it is hard to say whether Kodak, with its consumer expertise and dealer network, or HP, which makes digital cameras, PCs, servers and printers, is better placed. Perhaps they will succeed together: after all, the two firms have a joint venture, Phogenix, which makes digital photo-finishing equipment.

Another unresolved question concerns the countless photographs—estimated to number one trillion in America alone—languishing in shoeboxes. If digitising existing images can be made easy enough, it could open up a vast market in reprints.

One possibility, suggests Kodak's Pierre Schaeffer, is that the industry might eventually earn incremental revenues from the storage and sharing of photographs, as well as printing. But it will be some time yet before the right business model for digital photography comes into focus.

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Face value

Teaching the world a lesson

Jun 6th 2002
From The Economist print edition

By fighting convention, John Sperling has revolutionised adult education

SOCIALISM aspired to put what were once the privileges of the few into the hands of the many. As a historic movement, it may have foundered; but for one leftwinger whose political instincts were formed in the radical trade unions of the 1940s, its vision has inspired a capitalist triumph. John Sperling, former sailor, academic and union organiser, is ironically enough one of America's richest men.

The firm that he founded, Apollo Group, runs the University of Phoenix, the largest private university in America, and has 140,000 students enrolled at 170 sites. In 2001 Apollo made net profits of $108m on revenues of $770m. Its distance-learning division, with 37,600 students, is one of the few online education businesses not merely to have survived the dotcom crash but to have thrived through it. Mr Sperling, chairman of Apollo, which went public in 1994, owns around 16.5% of the company, whose market capitalisation has grown steadily to just under $6 billion.

Mr Sperling's politics may have shifted to accommodate the power of the market to introduce new ideas, but his impatience with complacency and convention has not. At 81, Mr Sperling cares little about the approval of others, and has devoted some of his wealth to sponsoring a range of neglected or unpopular causes. “What would be the point of supporting popular causes?” he asks. They already get plenty of money, whereas drug legalisation, pet cloning and saltwater farming to relieve famine, just three of his recent sidelines, have all been boosted by his contributions.

The idea for the University of Phoenix came in 1972 when Mr Sperling was teaching history at San Jose State University. As part of a federal project to fight teenage delinquency, the university arranged a series of courses for the police and for schoolteachers who had to deal with the youngsters. To Mr Sperling's surprise, these new students enjoyed their courses so much that they wanted to carry on with further study. Inspired, and realising what a huge potential market this was, he suggested to the university that it should set up degree courses for older people who were working full-time. But the board blocked the idea.

Thus spurned, Mr Sperling found a new home for his idea at the University of San Francisco. It was on the verge of bankruptcy and so readier than richer colleges to experiment. The Institute for Professional Development that Mr Sperling founded there adopted many of the principles that still govern education at the University of Phoenix: group learning through class interaction, teachers with professional experience beyond academia, and an emphasis on practical knowledge over abstract theory.

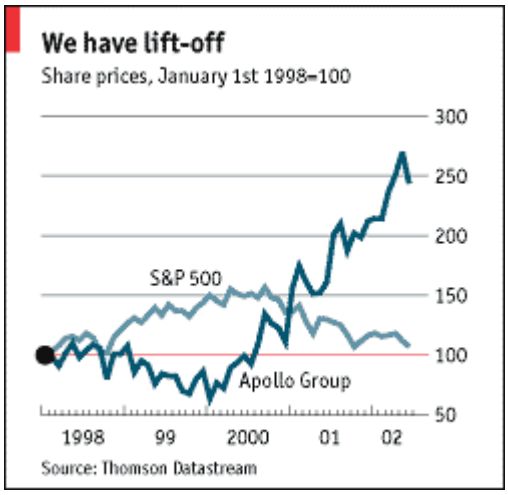
State educational regulators worried, however, that the institute's utilitarian approach was academically hollow, and threatened to revoke its right to grant degrees. Mr Sperling left California in 1977 to reincorporate the institute as the University of Phoenix in Arizona, which had easier-going regulators.

His battles with the academic establishment have continued, but these days he is well-armed, having turned his experience of winning political approval into a competitive advantage. “We have a huge political apparatus: 35 lobbyists on retainer,” says Mr Sperling, explaining how entry into each new state—the university is in 37 so far—has involved wooing its politicians.

The knowledge business

Time has vindicated Mr Sperling's vision of adult education as a growth business. More than 52% of America's working adults are enrolled in some sort of course. Lifelong learning is now a mantra in business, and Apollo has jumped in as new markets have appeared. Recent additions to the catalogue include a masters in schoolteaching, and professional certification in business techniques such as supply-chain management.

Educational firms often prosper during downturns, as workers turn to training to boost their chances of finding a job. Apollo's share price reflects this (see chart). Still, the dotcom crash knocked out plenty of would-be competitors that had seen the Internet as a way to reach working adults. The University of California and New York University have recently closed down their online arms, for example. Others have scaled back heavily: Fathom, backed by Columbia University, the London School of Economics and other institutions, has postponed its plans to charge money, instead offering some free courses and links to paying courses at other places.



The University of Phoenix Online, by contrast, has done well since being floated on Nasdaq in 2000. Indeed, the bursting of the Internet bubble has helped it, chuckles Mr Sperling, by making it easier to hire the technicians needed to support its expansion. An early start, in 1989, gave it time to learn, over five unprofitable years, how to re-create the emotional engagement of classroom work on a screen and so keep students involved.

Mr Sperling's relish in kicking down obstacles and seizing opportunity has served him well, propelling him on a classic American trajectory from rags—he was born in a log cabin in the Ozarks—to riches. It has also done wonders for both students and shareholders. But Mr Sperling's single-minded drive to avoid complacency at all costs does not always go down well with his colleagues. Some members of Apollo's well-regarded management team also appear a little anxious at its founder's promotion (in league with George Soros, another sceptical capitalist) of bills to decriminalise drug use, or his quest to clone his dog.

How long they have to worry about such awkward associations may depend on the success of another of Mr Sperling's sidelines. Kronos, which he founded in 1998, is one of America's top anti-ageing clinics. Mr Sperling means to carry on fighting convention for a long time.

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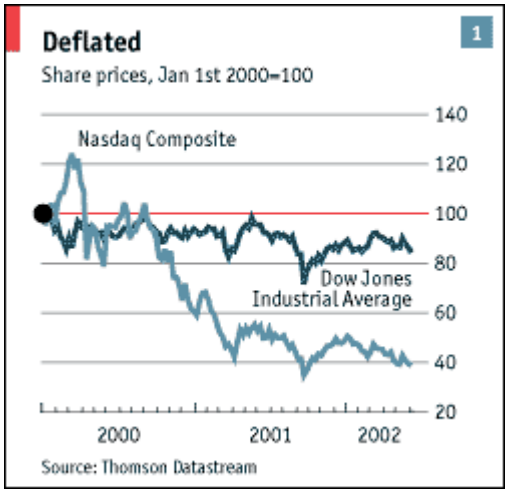
Wall Street

The value of trust

Jun 6th 2002 | NEW YORK
From The Economist print edition

Investors seem to have lost faith in Wall Street. What can be done about it?

AMERICAN stockmarkets fell at the start of this week, even as the economic outlook grew brighter. The Dow Jones Industrial Average and the technology-heavy Nasdaq touched their lowest levels for months (see chart 1). Investors have had their confidence bashed by a series of revelations of corporate malpractice and number fiddling before the stockmarket bubble burst. The continuing sagas of Enron and its auditor, Andersen, have kept their spirits low. Almost any half-suggestion of impropriety can make them twitch. This week they twitched at the resignation of Dennis Kozlowski, chief executive of Tyco International, a once high-flying agglomeration of ill-fitting businesses, days before he was charged with evading more than $1m in taxes on paintings that he bought last year in New York.



Investors have not only lost patience with corporate America's greed and its inability to do what it says it is doing; they have also lost confidence in Wall Street's ability to act as an honest broker between them, the providers of capital, and the corporate users of it. “There is an air of cynicism surrounding every institution that underpins our capital markets,” says Stanley O'Neal, co-head of Merrill Lynch, an investment bank that recently paid $100m to settle a lawsuit over the integrity of its analysts when the Internet hype was at its peak. “This cynicism has gone beyond reasonable questioning, and could easily turn destructive.” What should be done to divert this potentially destructive force?

Although there are important differences, there are also echoes today of the 1930s when, in the aftermath of a stockmarket bubble and the 1929 crash, Wall Street became public enemy number one. Business then went into a severe decline as investors and companies lost faith in the trading and issuance of securities. The Pecora hearings in Congress (named after Ferdinand Pecora, a lawyer who orchestrated the proceedings) provided an outlet for the public's Depression-era fury and humiliated leading Wall Street figures such as Jack Morgan, the boss of J.P. Morgan. (Famously, during a break in testimony a circus midget climbed on to the financier's lap and posed for photographs.)

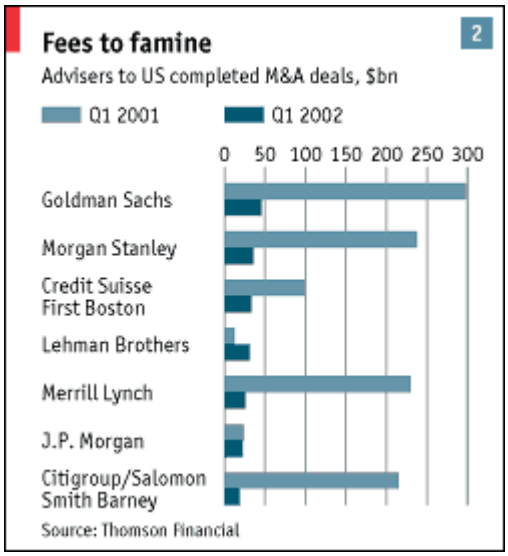
Congress passed several laws that imposed unprecedented regulation on the business of finance, all vigorously opposed by Wall Street at the time. The quality of this legislation was mixed, though the laws that defined the structure of the industry were worse than those that regulated the conduct of the industry's participants. The Glass-Steagall act, which banned firms from doing both commercial and investment banking, was eventually scrapped in 1999. But the creation of a “cop on the corner” of Wall Street in the shape of the Securities and Exchange Commission (SEC) proved to be a masterstroke, greatly increasing public faith in America's capital markets.

Today, Wall Street once again faces both a prolonged slump in business and the prospect of punishment and further regulation. Trading in shares by institutional investors, especially hedge funds, continues to accelerate. But many individuals who flocked to the stockmarket during the second half of the 1990s are now giving up en masse. Day traders (so called because they buy and sell stakes within the same trading day, thus producing a rich flow of commissions for brokerage firms) are now yesterday's traders. And many people who traded only occasionally, or who put their money into mutual funds, are also bailing out of the market.

According to the June issue of *Bank Credit Analyst*, a newsletter, retail investors have now “lost most of their profits accrued during the bubble years”. The BCA proxy for the average price paid for shares suggests that the cumulative profits of those investing steadily since 1995 are down to less than 10%, compared with a high of 40%.

Companies, too, are using Wall Street's services less. Both mergers-and-acquisition (M&A) activity and initial public offerings of shares (IPOs) are miles below their highs of 2000. The likelihood is that the depression on Wall Street will continue for some time, and that the recent rounds of job-cutting will not be the last. At the very least, firms will have to get used to much lower revenues and slower growth.

Everybody agrees that action is necessary to ensure that America's capital markets remain the best in the world. But the battle to lead that punishment and reform process promises to be unusually messy. That, in turn, makes the future path of reform highly unpredictable. As well as such assorted congressmen as Paul Sarbanes, Edward Markey, Jon Corzine and Richard Baker, state politicians such as Eliot Spitzer, New York's attorney-general, are jockeying for a share of the limelight.



Mr Spitzer brought the recent case against Merrill Lynch, which focused on internal e-mails in which Merrill analysts—notably their former Internet guru, Henry Blodget—abused Internet firms as “crap” and “shit” while simultaneously issuing research reports that urged investors to buy their stock. Now Mr Spitzer hopes to repeat his victory—Merrill paid $100m to settle the case, though it did not admit any wrongdoing and was never charged with any specific offence—by obtaining e-mails from Morgan Stanley (home to Mary Meeker, an analyst once known as “the queen of the dotcoms”) and Citigroup, whose telecoms analyst, Jack Grubman, is facing growing public scrutiny.

Worried that action by the states might undermine America's federal system of securities legislation, Congressman Baker recently wrote to state attorneys-general warning them that he would propose legislation to curb their activities if they continued to go their own way.

Self-regulatory bodies such as the New York Stock Exchange (NYSE) are also competing to show leadership. On June 6th the Big Board introduced new listing requirements for companies that will, among other things, force them to have a majority of independent directors on their boards. The NYSE boasts that these rules are much tougher than those introduced by the National Association of Securities Dealers (NASD) last month.

In an ideal world, the agenda would be set by the SEC, but it remains to be seen if its chairman of nine months, Harvey Pitt, can overcome a series of political embarrassments that have led to criticism from both right and left. Further complicating matters, countless private lawsuits are pending against financial-services firms that seem likely to drag on for years and may result in huge payouts. They are providing plenty of the sort of bad publicity that encourages politicians to turn up the heat on Wall Street more than might be good for its health.

Shaky analysis

How much punishment does Wall Street deserve, and what reforms does it need? At the most basic level, financial markets stand accused of knowingly selling over-priced shares by claiming they were cheap, and of doing so in ways that benefited some of their customers (and themselves) to the detriment of others. In particular, this boils down to three main concerns. One is about the role of the research that is

published by investment banks; a second is about the way in which shares in IPOs are allocated; and the third is about the use of accounting rules to mislead investors.

The focus on research analysts who allegedly advised investors to buy shares at prices they did not really think made sense has intensified since Merrill settled with Mr Spitzer. As well as Mr Spitzer's pursuit of Morgan Stanley and Citigroup, the SEC this week revealed that it is investigating ten cases of possible conflicts of interest involving analysts, while the NASD and the NYSE are looking into 37 such cases.

Even if these turn up no e-mails as lurid as Merrill's, there is every chance that firms accused as a result of these investigations will reach a (doubtless expensive) out-of-court settlement. For a financial firm to go to trial over such matters is to risk bankruptcy. The laws in the area are sufficiently untested for them to prefer not to present their case to a judge.

There is no doubt that Wall Street gave investors an unprecedented amount of bad advice; that those dispensing it often had an inkling that the firms they touted were probably overvalued; and that they had strong incentives to err on the bullish side. On the other hand, every piece of advice issuing from a Wall Street firm comes couched in caveats. If the oldest rule of the marketplace, caveat emptor—“buyer beware”—is to apply in such cases, then anybody slavishly following the advice of a Wall Street analyst has only himself to blame for his future losses.

Ominously for Wall Street, however, on June 3rd a Supreme Court ruling—in favour of an SEC action against a broker—stated that the securities markets' regulations introduced in the 1930s “sought to substitute a philosophy of full disclosure for the philosophy of caveat emptor, and thus to achieve a high standard of business ethics in the securities industry”. Caveat emptor does not go far enough, it seems. Analysts may have a legal duty of care for their retail customers, which means, for example, offering them only such advice as they would give to themselves.

What can be done to make Wall Street fall more into line with this philosophy in future? So far, the focus of reform has been to try to reduce the conflicts of interest that may encourage analysts to feign bullishness. One suggestion is that they should be prevented from owning shares in the companies that they track. But this tackles only one potential conflict. The more powerful arises from the huge rewards that analysts get, directly or indirectly, for promoting their firms' other services. An alternative (if far-fetched) suggestion is that they should be required to invest according to their own advice, but only after a delay to ensure that they are not able to anticipate their customers' future purchases.

There is some talk in Washington of drawing up legislation to ban investment banks from publishing research, which would certainly remove that conflict of interest. But there are not many examples of a firm of any scale surviving for long by selling truly independent research. And since the SEC introduced regulation fair disclosure (FD) in 2000, prohibiting firms from disclosing material information to one outsider before the market as a whole, the main source of competitive advantage for analysts—namely, access to privileged information through meetings with the companies' managers—has supposedly been destroyed. True, it is not yet clear that Regulation FD is being vigorously enforced by the SEC, which has yet to make a single prosecution under it. If it were, though, there would be even less to distinguish the insights of most research analysts from those of an ordinary investor.

In a recent speech, the SEC's Mr Pitt said that the main issue with the second area of concern, the IPO process, was that “valued brokerage-firm clients are given investment opportunities, but only in return for kickbacks to the brokerage firms that made the opportunity available”. This seems to have happened quite often recently. Indeed, one investment bank, CSFB, paid $100m to settle an investigation into its habit of allocating shares in IPOs to favoured clients who repaid a chunk of any profits that they made by subsequently conducting unnecessary trades with the broker.

Friends of Frank

But this is not the public's main concern about IPOs. Their worry is that they never get allocated shares in the initial distribution, and that to participate in an IPO they have to buy the shares at an exorbitant mark-up in the after-market. These are problems that the SEC could do something about (though, distressingly, it shows no signs of doing so), notably by ordering investment banks to use auctions to allocate shares in IPOs to the highest bidders. So far, despite the plucky efforts to promote auctions by W&R Hambrecht, a Silicon Valley investment bank, they are used in less than 1% of all issues.

It is not obvious why auctions should be shunned, especially as W&R Hambrecht charges only 4% of the

money raised compared with Wall Street's norm of 7% (a norm so entrenched that it sometimes seems surprising that it has not aroused the interest of antitrust authorities). One possible explanation is that the management of issuing firms may be co-opted into going along with an investment bank's underpricing of their issue by the promise of “friends of Frank” accounts.

Named after Frank Quattrone, an investment banker who led CSFB's technology-industry group in the heyday of the dotcom euphoria, these accounts were given to managers as a reward for hiring CSFB. Through them, they received preferential allocations of shares in future IPOs. In effect, this aligned the interests of the company's managers with those of Wall Street, while putting them in conflict with the interests of their own employer.

A solution to this would be to require full disclosure of any other relationships that managers of companies going public have with their underwriter. Jay Ritter, an economist at the University of Florida, says that it would be even better if there were a total ban on dealings between managers and the underwriter until, say, at least two years after their company's flotation. He expects the next round of lawsuits against Wall Street to target the underpricing of IPOs, especially if (as he thinks likely) the suit recently filed by eToys against Goldman Sachs succeeds.

The erstwhile Internet toyshop claims that it was deprived of cash that could have kept it alive because the investment bank deliberately underpriced its IPO in 1999 so as to gain illegal kickbacks from investors who were allocated shares in it. Given that total IPO underpricing during 1999-2000 amounted to $66 billion (based on the difference between the price at issue and the price at the end of the first trading day), the payouts in such cases could eventually be huge.

There may be trouble too if underwriters are shown to have known more than they let on when selling securities in firms that later stumbled. J.P. Morgan Chase is suing insurers who are refusing to pay up on a $1 billion surety bond tied to Enron, claiming the bank misled them about the risk. And on June 4th it emerged that the SEC is investigating claims that Citigroup underwrote shares in Adelphia, having earlier made undisclosed loans of $3.1 billion to the scandal-hit telecoms firm and its founders, loans which were used to support its share price.

Called to account

The issue troubling investors more than any other, however, is the third of the three main concerns: the quality of financial information that is provided by companies. This is largely due to failures of accounting and corporate governance that are not, at first glance, really Wall Street's fault. However, it was the investment banks that supplied much of the financial alchemy that firms have used to hide the truth—such as at Enron, with its various off-balance-sheet financial structures.

It is in responding to this concern that Mr Pitt's SEC may yet turn out to be revolutionary. Despite criticism over potential conflicts of interest due to his previous employment as a lawyer working for big accounting firms, Mr Pitt is starting to transform the way in which accounting standards are set, and the legal obligations on companies to use accounting data to promote a true picture of their financial condition and risk. He has started to tell the Financial Accounting Standards Board (FASB), America's main accounting-standards setter, what its agenda should be, and he has ordered firms to make clear the most important assumptions they have made in their choice of accounting treatments (and to show how other choices would have made a difference).

He is also requiring firms to announce material changes in their outlook at the earliest opportunity, and is even taking action against firms which abide by accounting principles but do so in misleading ways. For example, Edison Schools, a school-management company, was recently told to stop booking revenues that never really passed through its coffers, even though this did not technically breach accounting rules.

As for better corporate governance, the NYSE's new rules are a step in the right direction. Much will depend on how committed the exchange is to ensuring that the rules are honoured in the spirit as well as by the letter. Greater independence of non-executive board directors is certainly desirable. Too many American bosses fill their boardrooms with yes-men who have neither the character nor the financial incentive to challenge the boss's grandiloquence. Ultimately, however, governance is unlikely to

improve much until the institutions that own large chunks of corporate America start acting as real owners, by keeping a sharper eye on their boards and their management.

Joseph Grundfest, a former SEC commissioner, argues that Wall Street firms may be less to blame for the corporate messes currently unfolding than corporate managers and boards, or their auditors. “Wall Street firms,” he says, “clearly have the deepest pockets” at a time when angry investors are looking for any recompense for the sins of the past—which means that they are probably in for a torrid few years, a time in which they will find out how much it costs to lose the trust of investors. It is easy to see why Merrill Lynch's Mr O'Neal is worried about the destructive possibilities of today's air of cynicism.

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The dollar

A cliff-hanger

Jun 6th 2002
From The Economist print edition

Getty

How might a weak dollar affect the global economy?

Get article background

CURRENCY forecasters who have long predicted its decline have seen the dollar climb inexorably for years. At last it seems to be turning. Since February the dollar has fallen by 9% against the euro, to a 17-month low of $0.94. It has also hit a six-month low against the yen, of ¥123. It may well fall further over the coming year.

Two factors weigh against the dollar. First, it is by most yardsticks overvalued. Its trade-weighted level, adjusted for inflation differentials, remains well above its average over the past couple of decades (see chart). And second, America's large current-account deficit, at more than 4% of GDP and growing, looks unsustainable. If the dollar stays roughly where it is as the economy rebounds, then the deficit will grow. As a rule, once a country's external deficit approaches 5% of GDP, its currency tends to fall.

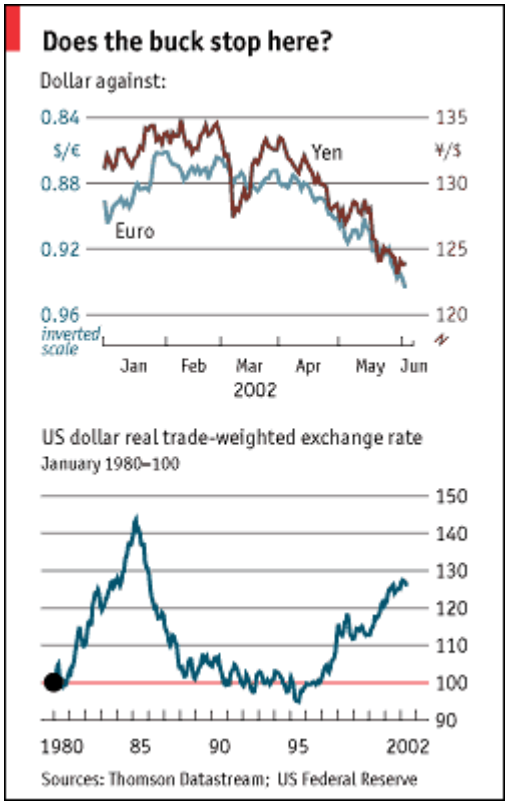
To trigger a slide, foreign investors do not have to become net sellers of American assets. The dollar will fall if they merely reduce the pace at which they add to their holdings. It will fall even more if American investors continue or expand this year's buying of foreign assets, notably European equities.

Until recently, net capital inflows more than covered America's current-account deficit. Yet investors are now reassessing their expectations about future relative returns. Recent data appear to confirm that America's recovery is on track. Indeed, *The Economist*'s latest poll of forecasters (see article) suggests that the American economy is again expected to outpace Western Europe and Japan this year.

Still, the part of this growth that finds its way into company profits is in greater doubt. America's productivity growth may have risen, but the fruits have so far gone mainly to workers and consumers, rather than to profits. And a growing band of investors guesses that higher potential returns now lie in Europe and Japan—so long as governments carry out reforms and firms continue to

restructure.

Over the past year, America has had to rely more heavily on fickle short-term capital flows, into bonds and equities, in order to finance its current-account deficit. Figures from CSFB show that foreign direct investment financed 91% of America's current-account deficit in 1999. By last year the figure had fallen to only 43%; this year it has probably slipped further.



Currency complacency?

Most forecasters predict another fall in the dollar, but they generally expect it to be gradual and relatively painless—except, of course, for foreigners with large dollar holdings. For example, UBS Warburg expects the dollar to fall to $1.05 to the euro and to ¥115 by the end of 2003—a drop of around one-sixth from its peak earlier this year. George Magnus, the bank's chief economist, argues that a gradual fall in the dollar would benefit the world economy. It would underpin America's recovery, by helping to bolster exports, profits and investment. A stronger euro and yen would also intensify the pressure for structural reform and corporate restructuring in the euro area and Japan.

By helping to hold down inflation in Europe, a strong euro would also reduce the pressure on the European Central Bank (ECB) to raise interest rates. For Japan, however, a weaker dollar would be bad news, threatening to choke a nascent recovery. With interest rates already close to zero, the exchange rate is one of the few policy tools left for the Bank of Japan. GDP figures for the first quarter, due to be published on June 7th, are widely expected to show strong annualised growth of around 5%. However, Japan's GDP figures are notoriously volatile, many economists reckon that output will stumble again in the second quarter.

The Bank of Japan has intervened four times in the past two weeks in a bid to hold down the yen. Yet intervention rarely has much effect unless it is carried out jointly with other central banks. A new paper by Takatoshi Ito, an economist at the University of Tokyo, finds that joint intervention in the 1990s was 20-50 times more effective than intervention by the Bank of Japan alone. This time round, the Federal Reserve and the ECB are unlikely to join in, as both would be reasonably happy with a weaker dollar.

America's economy would certainly benefit from a moderate fall in the dollar. Some economists fret that this would push up inflation and thus force the Federal Reserve to raise interest rates. Yet the Fed would probably be happy to see some increase in inflation. America's GDP deflator, the broadest measure of inflation, rose by less than 0.5% at an annual rate over the past two quarters, its lowest for almost 50 years. This is getting close to deflation.

While a moderate decline of the dollar might be benign for the world, a sudden plunge would be another story altogether. It would probably trigger a slump in American share prices, and a rise in bond yields, as foreigners pulled out their money. Foreigners own fully two-fifths of American Treasury bonds, a quarter of corporate bonds and 13% of American equities. Share prices around the world would probably be hit.

While a moderate decline of the dollar might be benign for the world, a sudden plunge would be another story

A further drop in share prices would erode consumer and business confidence,

and harm world growth. There is also a question over whether the ECB would react fast enough to a dollar crash by cutting interest rates to offset the deflationary impact on the euro-area economies. Stephen Roach, at Morgan Stanley, estimates that a 20% fall in the dollar over six months could knock up to one percentage point off global growth over the following year.

For now, most economists are sanguine, expecting a moderate fall in the dollar towards its “fair value”, rather than a plunge. These are the same forecasters who in 2000 failed to predict a bear market in shares (the S&P 500 is now one-third below its peak) and who last year ruled out a recession. Currencies almost always overshoot, downwards as well as up. From its 1985 peak, the dollar fell by half against the D-mark within two years. A repeat performance is possible.

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Indian housing finance

Safe as houses

Jun 6th 2002 | MUMBAI
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The central bank sparks a battle among mortgage lenders

GRIMY textile-mill chimneys on the Mumbai skyline are giving way to new high-rise apartments. Where India's financial capital leads, other cities follow: a boom is on. Property prices have fallen by a third from their highs of the early 1990s, enough to spark fresh demand. Tax breaks and falling interest rates have helped, and home loans are growing by over 30% a year. In April the Reserve Bank of India halved the amount of capital that banks must assign to home loans.

That has fuelled a price war among lenders. The State Bank of India (SBI), the biggest bank and a latecomer to the mortgage market, cut interest rates on home loans by half a percentage point. The biggest privately owned bank, ICICI, followed soon after. Last month the Housing Development Finance Corporation, HDFC, which has over half the market, also cut rates; it offers free credit cards and insurance as well.

By encouraging mortgage lending, the government hopes to revive a slowing economy and to help the banks through a slump in corporate lending. There is a potential demand for at least 30m new homes, and since aspirations are rising faster than incomes, cheap home loans can help bridge the gap.

The Indian mortgage market is tiny. Standard Chartered puts outstanding mortgages at around $9.6 billion, or about 2% of India's GDP. Reforms are needed, such as the removal of barriers to land development and controls on rent, if housing is to do more to spur the economy.

Banks see past those barriers. Consumer lending is equivalent to a mere 3% of GDP. Cheap deposits, plus 9,000 branches spread across the country, have helped SBI to increase its home loans by two-thirds in the latest fiscal year, to $1.6 billion, making it the second-biggest mortgage lender. ICICI, whose home loans more than tripled last year, seems ready to forgo quick profits in order to win customers. The more customers it has, says Chanda Kochhar, an executive director, the better it should be able to control costs and prices. Of the foreign banks, Standard Chartered expects half its profits from retail lending to come from home loans; Citibank is trying to create a secondary market for mortgages; and ABN Amro plans to start selling home loans this year.

The Indian consumer is at last getting a better choice. Nearly all banks now offer floating-rate loans, charge low fees and amortise a mortgage's principal every month rather than once a year—though that is something the market leader, HDFC, has yet to do.

Bad loans, however, are made in good times. Indian banks, particularly the state banks, lack experience in mortgages. Banks that have forced down the price of fixed-interest mortgages may be in trouble once interest rates rise, says Sarvesh Sarup, head of consumer banking at Citibank. And cutting rates to attract new customers runs the risk of annoying existing ones.

The banks may be blind to other risks, too. Typically, they lend up to 85% of a property's price, but some banks have teamed up with local developers to lend as much as 100%. That leaves no cushion should property prices fall again. And they may fall, says Tariq Vaidya of Knight Frank, a property-services firm, as more land is freed for development.

For now, default rates on home loans seem reassuringly low: just over 1% at HDFC, for instance. Still, credit information about customers is scrappy, and foreclosure laws are weak. That means banks must handpick their borrowers—a time-consuming practice.

Could cheap bank loans create a property bubble, as they did elsewhere in Asia in 1997-98? Unlikely,

says Vishu Ramachandran, head of consumer banking at Standard Chartered. For a start, most borrowers are buying modest first homes in the suburbs—nothing fancy. If prices drop, these buyers will do their best to keep up their payments. What is more, during the Asian boom, it was speculative investors who drove the market. This time in India, says Mr Ramachandran, banks, not speculators, are making the running. So that's all right, then.

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Property in Hong Kong

End of an era

Jun 6th 2002 | HONG KONG
From The Economist print edition

Being a property tycoon is not what it used to be

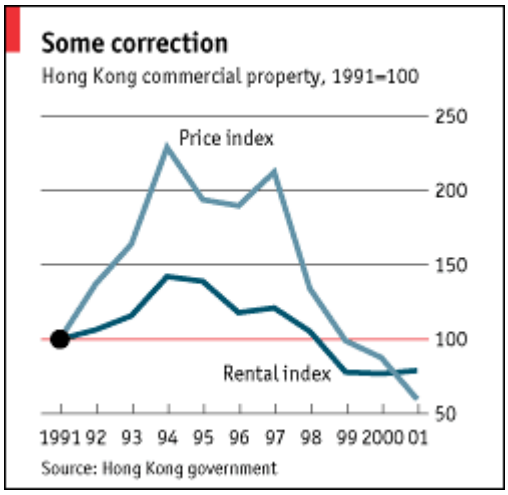
OVERWHELMINGLY, the people in Hong Kong who host the most flamboyant parties, own the biggest yachts, charm the most beautiful women and influence the city's political elite tend to be greying property developers. Yet they are a lagging indicator, reflecting fortunes made in the past that are now shrinking. The days when there was big money in Hong Kong property are over, perhaps forever.

As a reminder, late last month Standard & Poor's (S&P), an American credit-rating agency, downgraded the ratings of three of the city's largest developers, pronounced pessimism over the ratings of another four, and placed the property arm of Li Ka-shing, Hong Kong's wealthiest and best-known tycoon, "on watch". In the past, says John Bailey of S&P, Hong Kong's property market was a ticket to wealth, thanks to inflation, undersupply and speculative excess. In future, there will be deflation, oversupply and a lack of speculators.

This is, to some extent, a familiar theme across much of East Asia. In the 1980s and 1990s, a generation of businessmen, mostly ethnic Chinese, used property as a platform to amass business empires, only to see them disintegrate in the financial crisis of 1997-98. The skylines of Bangkok and Jakarta are still dotted with empty or even unfinished office towers.

In Hong Kong, the property bubble was official policy. All land in Hong Kong, except the ground under the Anglican cathedral, belongs to the government. It lets the land on long leases. In the mid-1980s, during negotiations over Hong Kong's return, the Chinese suspected that the British might sell the land and cash out of the colony in its final years. The two sides agreed to restrict the supply of new land for development until the territory's handover in 1997—after all, rising prices, even if artificially induced, were good for confidence. The duration and end of this artificial shortage coincided perfectly with Asia's boom years and with its bust. Supply was low when demand was high—and then increased when demand dived.

Hence the slump in prices and rents of commercial as well as residential property since 1997 (see chart); and the shrinking profit margins of the developers. Even if now—two recessions later—demand recovers in Hong Kong, the oversupply will last for years. In order to boost their cashflows, the companies need to develop the vast land banks that they built up in anticipation of future development. For tycoons with much of their business still in Hong Kong—such as the Kwok brothers of Sun Hung Kai, the largest developer, or Lee Shau-kee, the patriarch of Henderson Land, who briefly ranked as Asia's richest man in the boom years—this probably spells slow decline.



Other tycoons have seen the writing on the wall, and done something about it. Li Ka-shing long ago expanded into ports, retailing and telecoms (although there are now concerns about his exposure to third-generation mobile telephony). Some are shifting their attention to mainland China. Vincent Lo, who heads Shui On, a middle-sized developer, says that he stopped bidding for Hong Kong land in 1993. Over half of his assets are now on the mainland, and in ten years he expects that four-fifths will be. In Shanghai, he reckons, returns for property developers are near 30%. That could be the next city to make developers rich at first, but poorer later.

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A tax haven for Japan

In Nago's fair city

Jun 6th 2002 | OKINAWA
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A dream takes shape in Japan's southern islands

TATEO KISHIMOTO, mayor of Nago, a small city in Okinawa, visited Dublin two years ago and decided that Nago, too, should be a tax haven. He was impressed by how the Irish capital had prospered by strengthening its technological and financial infrastructure and by offering tax breaks. Mr Kishimoto needed to create jobs at home and boost the local economy.

His hardest task was to persuade politicians and the powerful Ministry of Finance to pass special laws allowing unprecedented tax breaks in just one region. But the island of Okinawa, Japan's southernmost prefecture, is somewhat special, having reverted to Japanese control only 30 years ago, after 27 years of American military rule. It is still home to around 26,000 American troops. Okinawa's long isolation from the mainland still causes pangs of guilt in Tokyo.

The battle was won when Sadanori Yamanaka, a politician with legendary influence over the tax bureau within the finance ministry, gave it his support. New laws allow Nago to set up a special zone for ten years, offering tax breaks to financial and information-technology companies with head offices there. The taxable portion of income in the zone will be reduced by 35%—equivalent, roughly, to a 10% tax cut. However, only companies that employ more than 20 workers will be eligible, and tax savings may be no more than one-fifth of staff costs.

Nago is now waiting, Mr Kishimoto chuckles, for Okinawa's prefectural government, which did not expect the law to pass, to delineate the zone. Cheap labour costs have already attracted many call-centres to Okinawa, and these are expected to thrive under the new scheme. Those belonging to Citibank, Nomura Securities and IBM, among others, have already brought 3,800 new jobs to Nago. Mr Kishimoto wants more.

Cheap labour costs have already attracted many call-centres to Okinawa

His other ambition is more controversial: to make Nago a centre for captive insurers. These are vehicles set up by businesses and insurers to insure the parent company's risk. Captives are not recognised in Japan as insurance companies, so Mr Kishimoto plans to lobby the Financial Services Agency (FSA) for special provisions to set them up. There may be other ways around the constraint, say bureaucrats. If so, hundreds of captives could spring up in Nago, say supporters of the scheme, although not many would qualify for tax breaks: they are usually paper companies with few employees.

It is not clear which ministry or agency—if any—would supervise the new industry. The FSA is thought to be reluctant. So is the Cabinet Office, which will dish out licences to operate in the tax haven and is hastily brushing up its financial skills. Captive insurance, if given a green light, could end up unhampered by any but the most basic laws governing non-financial companies.

There is some interest among insurers such as Aon, an American insurance broker, Yasuda Fire & Marine, Japan's second-biggest non-life insurer, and America's AIG, the world's biggest insurer. At a seminar for 80 companies, held by Nago in Tokyo last November, AIG helped to explain new trends in captive insurance.

Much remains to be done. Fresh proposals will be subject to vetting by the finance ministry, the FSA and

politicians, who worry that the zone could be used for tax evasion and money-laundering. Meanwhile, sceptics wonder whether captives—designed to lower corporate insurance costs—will take off at all in a country in which the cost of insurance is falling rapidly, thanks to recent deregulation.

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Research analysts

Number crunch

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A rough guide to the accuracy of forecasts

ORDEAL by New York state attorney-general is one way of trying to set research analysts on the straight and narrow: ask Merrill Lynch. But another way is to measure, and publicise, precisely how closely analysts' predictions of company earnings match the results. Such predictions—which continue right up to the day before a company publishes its figures—are the bread-and-butter business of share analysts.

Much depends on how predictable a company's profits can ever be. Over the past three years, telecoms companies have produced far worse results than analysts in Europe managed to forecast. The forecasts in Europe of earnings at oil and gas companies have been wide of the mark, too, thanks to volatile energy prices. Still, the accuracy of analysts' earnings-per-share forecasts should offer a rough guide to how valuable their research is to the investor.

One European firm, AQ (short for accuracy quotient) Publications, has been rating equity analysts at stockbroking firms and investment banks for three years, using data provided by First Call/Thomson Financial. Its latest report shows that analysts from small European firms can hold their own with the big investment-banking groups. According to its rankings, Natexis Capital in Paris does best for stocks in the FTSE Euro 100 index, and Williams de Broe in London scores highest for companies in Britain's FTSE 100 index.

Yet Schroder Salomon Smith Barney, part of Citigroup, probably shines overall, since it covers 179 of these 200 companies and still ranks fourth on both the FTSE 100 and the Euro 100 indices. Down the rankings, big names such as J.P. Morgan Chase, Morgan Stanley and Goldman Sachs rub shoulders with many that are less familiar. Commerzbank comes bottom for analysing FTSE 100 companies and second-to-bottom for the Euro 100.

Does any of this matter? There are many reasons why companies defy forecasts or match them—some stemming from how well they manage expectations, and how much they can smooth earnings. Spanish companies can smooth better than most, says Graham Field, managing editor of AQ, while German earnings tend to be the least predictable. Forecasting Deutsche Bank's profits this year was an analyst's nightmare, as the bank switched from German to American accounting standards. Yet Natexis was on top of the change, says Mr Field, perhaps because the methodology of a small firm is typically more flexible.

AQ's endeavour was inspired by a fund manager who was looking for a rigorous way to rate stockbroking firms' analysts. StarMine does a similar exercise in America. If it leads to more comparable forecasts by analysts and fuller disclosure by companies, then it will have achieved something. But will fund managers submit their own analysts to the test?

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Swiss private banking

Upscale

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Big in Geneva is not inevitably beautiful

A MERGER between two Swiss private banks ought to be no big deal. In an era of global financial consolidation, the fusion of all five in Geneva would combine about SFr250 billion ($160 billion) of assets under management, less than 1% of the world's fund-management market.

Yet private banking is about more than amassing assets. Indeed, the merger of Lombard Odier and Darier Hentsch, both founded over 200 years ago, announced on June 3rd, is a sign of weakness and loss of direction rather than strength.

Darier Hentsch suffered a blow in October when its most visible senior partner, Benedict Hentsch, stepped down because of his involvement, as vice-chairman of Swissair, in the airline's collapse. But critics say the bank had already lost its way. Lombard Odier rode the equity boom of the past decade, particularly in technology shares; it even ventured into such alien territory as corporate finance and investment banking. But that drove up the bank's fixed costs, just as it has for its listed rivals in Zurich, Vontobel and Julius Baer.

Now, unless they shrink back to their traditional business, the private banks need to find economies of scale, and that means expansion. Lombard Odier Darier Hentsch (LODH) will employ around 2,000 people and have SFr140 billion under management. There ought to be savings in information systems, and operational and regulatory costs should be lower. Yet LODH will come head-to-head against the private- and institutional-banking arms of the biggest: UBS, J.P. Morgan Chase and Credit Suisse. Maybe joining their ranks is the answer.

A recent study of private banking by UBS Warburg suggests that the returns from private banking can be good—eg, a 30% return on equity—with as little as $10 billion under management. More important than scale is the quality of income. Fees from discretionary portfolio management are desirable; fees that reward transaction volume, or switching money from one fund to another, suffer in bear markets, and they bring conflicts of interest.

The true appeal of Swiss private banking—its famed secrecy—is waning, because of an international drive against money-laundering. That is tempting the banks to reinvent themselves. Yet by going for scale, they may be destroying their oldest attraction, which is attentive service to clients. That used to include lunching fur-clad ladies and sorting out children's schooling and other family affairs. Swiss banks scale these things up at their peril, one veteran Swiss banker cautions.

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Economics focus

The education shibboleth

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From The Economist print edition

Extra years of schooling and wider access to university are everywhere supposed to be good for growth. Think again

ONE of the bravest, most interesting and most valuable books about economic policy to have appeared of late has just been published—and it was written by a non-economist. Alison Wolf is a professor of education at the University of London. Few academics with a position such as that would choose to write a book questioning what is today probably the most cherished myth of economic policymakers all over the world: the idea that more education is the key to economic success. Yet this is the daring mission which "Does Education Matter?" takes on*. The book is chiefly concerned with Britain, whose prime minister, Tony Blair, declared his three highest priorities in government to be "education, education, education". The arguments and the findings are of much wider relevance, and of pressing importance too.

So far as individuals are concerned, the evidence reviewed in the book shows, as you would expect, that education—"having the right qualifications, in the right subjects, from the right institutions"—matters. Indeed, it matters more than ever before. Those who leave school early or without qualifications are tagged, as it were, for low incomes, with a probability that is high and rising. Increasingly, those who fail to get a degree, or in some cases a degree from a good university, are sorted in a similarly brutal way. In other words, the private returns to education are high. But another question also needs to be answered, especially in countries with education systems (up to and including the universities) that are financed by the state: namely, what are the returns for society as a whole?

The book shows that they can be a lot lower than you might think. In particular, more education does not necessarily mean more growth, as most politicians (and economists) unthinkingly suppose.

The doubts do not arise so much over primary and secondary education. Modern societies depend on high levels of literacy and basic skills in mathematics. If students leave primary and secondary schools without them, that is a public burden as well as a private one. At the top, modern societies also need excellent universities producing substantial but not vast numbers of graduates equipped to be researchers and practitioners in medicine, engineering and the sciences. More generally, education does (or can) contribute to an individual's human capital, which makes people more productive. And if a society's individuals are more productive, you might suppose, the society itself is more productive.

So what is the problem? If all this is true, how can more education fail to make a country more prosperous? A first crucial point is that education is a "positional good": that is, getting yourself tagged for high wages is not just about being educated, it is also about being better educated than the next man. To some extent, education is a race: if everybody runs faster, that may be good in itself, but it does not mean that more people can finish in the top 10%. In that sense, much of the extra effort may be wasted. In weighing the social benefits of higher spending on education against the cost, this needs to be borne in mind.

Where the book excels is not in making this somewhat familiar point, important though it may be, but in drawing attention to other dangers in the present obsession with education and growth. One is that expanding education thoughtlessly may actually weaken the link with growth, such as it is. Another is that the preoccupation with economic growth narrows and distorts society's idea of what education should be.

In Britain, as in many other countries, the economic emphasis has produced a fixation with quantitative targets: the government wants ever more people to

The increase in

go to university, and has tailored its financing policies to that end. The increase in numbers appears to have reduced the average quality of a university education. That is one cost. Any gains to be expected from pushing out more graduates are then further reduced by the positional-good effect. In addition, expanded recruitment of teachers at the tertiary level drains the best recruits from teaching posts in secondary schools. Worst of all, maybe, from an economic point of view, the best universities are being starved of resources. As a result, they are no longer able to do as good a job of preparing the very brightest students for their role at the cutting-edge of science and technology.

numbers appears to have reduced the average quality of a university education

Equally impoverished

Why should this draining of resources from elite universities happen? You may think it unlikely, especially if the government is convinced that education spurs growth. Experience proves otherwise, as the book shows. Great efforts to expand the number of graduates have gone hand-in-hand with budgetary stringency across the system, to make the overall strategy affordable. Also, in a regime that is moving towards very wide access to university education—for the most part, at taxpayers' expense—it becomes politically difficult to discriminate in favour of the top universities. That would undercut the egalitarian thrust of the whole enterprise. Thus the best universities find themselves squeezed, and one of the main links between education and economic growth gets hammered.

Measured against its own bean-counting goals, “education, education, education” leaves a lot to be desired. But in any case, the book insists, education is about more than economics. (This column's prejudices, you see, are not spared.) Insisting on ramming more people through a degraded university system is not just sure, for all the reasons mentioned, to disappoint economically. It is also bound, through its self-defeating preoccupation with economic growth, to sideline aspects that do not claim to serve that purpose. “Our recent forebears”, the author concludes, “living in significantly poorer times, were occupied with the cultural, moral and intellectual purposes of education. We impoverish ourselves by neglecting these.”

* “Does Education Matter? Myths about Education and Economic Growth”, by Alison Wolf. Penguin Books.

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The physics of information

It's all just number-crunching

Jun 6th 2002
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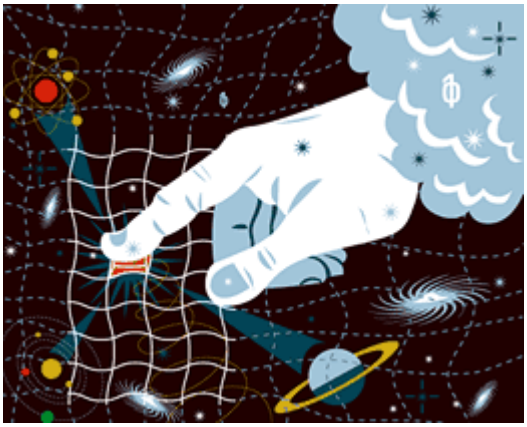
The universe may be the largest computer in, well, the universe



"COGITO ergo sum" was Descartes's stab at providing a demonstration of the fact of his own existence. John Archibald Wheeler, an American physicist, tried to go one better. He coined the phrase "it from bit" to provide a proof of the existence of everything in the universe. Dr Wheeler's idea is that if a thing contains a "bit" of information, which is the amount necessary to answer any yes-or-no question, then it must exist.

Although less lucidly phrased than Descartes's, Dr Wheeler's notion has exerted a powerful influence on physicists over the years. It has led some of them to add information to the catalogue of fundamental ingredients from which the universe is concocted, alongside matter and energy. It has also fuelled the development of a new branch of science. Researchers still study the physics of stars and atoms to discover how much matter and energy the universe contains, of course. But they now study the physics of information to work out how much of that the universe holds, as well.

One such physicist, Seth Lloyd of the Massachusetts Institute of Technology, recently took this approach to its logical conclusion by trying to calculate the maximum computing capacity of the entire cosmos. His results, published in the current issue of *Physical Review Letters*, lend support to Dr Wheeler's notion that information theory can provide important insights into physical reality.

A bit more like it

Dr Lloyd began by imagining the universe as a single, enormous computer. Like a standard laptop, such a computer would become more powerful as the size of its hardware shrank and its software became more efficient—that is, consumed less energy when manipulating a bit of information. But this race to the bottom must end when these factors reach certain fundamental physical limits.

The first of these limits, on energy, imposes a cap on how fast the universe-as-computer could switch a bit of information from one state to the other (a process known in the jargon as a logical operation). A bit may be constructed from any object that can take on two states. The smallest pieces of hardware in the universe that are suitable for this task are particles such as atoms and electrons. Both possess a quantum property known as "spin" that can be flipped from pointing up to pointing down. But flipping even an electron's spin consumes energy. Moreover, the faster a spin is flipped, the more energy the process consumes.

Since the universe contains only a finite amount of energy, there is a limit to the rate at which it can perform such operations. Using current estimates of the amount of energy in the universe, Dr Lloyd was able to arrive at a total for the number of operations per second that the universe could perform, were it a computer. By multiplying that number by the age of the universe—ten billion years—he arrived at the grand total. The universe, it transpires, could have performed 10^{120} (a one followed by 120 zeroes) logical operations during its history.

So much for the universe's software. Totting up the amount of hardware, or physical bits, that the universe-as-computer contains was the second challenge. To work this number out, Dr Lloyd turned to another physical property of the universe—its entropy, or disorder.

Scientists have long known that any physical system, such as the atoms in a particular volume of gas, can be thought of as containing information. The bits of information in such a system correspond to how the system's components exhibit certain features such as energy, spin and charge. The more degrees of freedom, or disorder, in the system, the more bits of information it can be said to possess.

The universe would be at its most disordered, and thus at its richest in bits, if all the matter in it were converted into radiation rather than being its current mixture of matter and energy. (Energy and matter are interchangeable; the rate of exchange was laid out by Einstein in his well-known equation, $E=mc^2$.) That is because matter is locked into position, and thus has fewer degrees of freedom than footloose energy. By working backwards from the upper estimate of entropy in a pure-radiation universe, Dr Lloyd guessed that, if every particle in the universe had every possible degree of freedom available to it, the universe would hold 10^{90} bits. In addition, quantum theory suggests that entropy is added to the universe by gravitational fields such as those curled up inside black holes. Adding this in, Dr Lloyd reckoned that the sum works out at about 10^{120} bits.

Mixed metaphors

That is a pleasing coincidence. Since the number-of-operations estimate came from information theory, and the number-of-bits estimate came from physics, Dr Lloyd takes the coincidence between the two as evidence of an underlying connection between information theory and physical reality. At the absolute maximum, therefore, the universe-as-computer could have performed one operation on each of its bits. In keeping with Dr Wheeler's view, the universe could therefore be seen as the “it” that has emerged from a one-time setting of each of its constituent bits.

Dr Lloyd is a believer in the large-scale feasibility of quantum computers—devices that promise to deliver enormous computational power by placing individual bits of information in two states at once, so that they can process many different logical combinations simultaneously. The small quantum computers that have been built so far use individual atoms as their physical bits. Sceptics doubt that such devices, which now hold fewer than ten bits, can be expanded much farther. What grander proof could Dr Lloyd offer that a large quantum computer could be made to work, than the suggestion that the entire universe is one itself?

From the Big Bang onwards, says Dr Lloyd, the universe has been “computing its own dynamical evolution”. If it all sounds too fanciful to be true, chalk it up to the tendency of quantum physics to attach the most exact probabilities to even the most remote outcomes. If somebody is determined to count angels on a pinhead, he may as well be precise about noting how many there are.

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About sponsorship

The origin of migraines

Head cases

Jun 6th 2002
From The Economist print edition

The traditional explanation for migraines may have things backwards—with significant consequences for sufferers

MIGRAINES are a big headache. One woman in five and one man in 15 suffers from them. In Britain alone, some 90,000 people are absent from work every day as a result of migraines, at a cost to the economy reckoned by some to be £750m ($1.1 billion) a year. Popping a pill or two can help to alleviate the symptoms, but safe, specialised drugs designed to keep migraines at bay do not exist.

That may, in part, be due to a fundamental misunderstanding of how migraines happen. Work by Peter Goadsby and his colleagues at the Institute of Neurology in London, among others, suggests that a widely accepted explanation of migraines is actually the wrong way round— and that the focus of existing therapies is therefore wrong, too.

This accepted explanation is that the initial cause of migraines lies in the blood vessels of the head, rather than the nerve cells of the brain. Arteries leading to the brain constrict in response to an unspecified external trigger. That leads to reduced blood flow, causing nerve cells in the afflicted area to function abnormally.

It is this malfunction, supposedly, that creates the so-called “aura” of a classical migraine: the flashing lights, areas of visual loss and even pins and needles in the face or limbs that torment some sufferers. The pain, by contrast, is blamed on the blood vessels themselves. These, it is supposed, dilate as a reflex reaction to the initial constriction, and the pressure thus produced triggers pain. Drugs designed to curb migraine pain have therefore aimed at stopping blood vessels dilating.

Brain-imaging studies suggest, however, that migraines are neurological disorders, rather than circulatory ones. Again, there is an external trigger, but in this case it causes nerve cells in such areas as the visual cortex to fire off wildly and then become quiescent. That creates the phenomena of the migraine aura. Increases in blood-vessel diameter are, indeed, observed in some patients. But Dr Goadsby has shown that types of head pain other than migraine lead to dilatation of the blood vessels, so it does not appear to be a special feature of the condition.

Dr Goadsby believes that the pain associated with migraine is actually due to the brain's misinterpretation of signals from elsewhere, and is nothing to do with this dilation. Rather, it is because those suffering migraines have a problem processing normal stimuli such as light, sound and probably pain signals, too. Such normal signals become, as it were, painfully amplified. This theory is backed up by brain scans which show that another part of the brain, its stem, is also a centre of abnormal activity during a migraine attack. The brain stem is the area which controls the reflexes of hunger and breathing. It also acts as a filter, allowing people to edit out distracting or unwanted signals such as background noise. When it goes awry, signals crowd in, causing a system overload.

This hypothesis allows patients with doctors who endorse it to benefit from imaginative prescription. In particular, the anti-convulsant drugs used by epileptic patients to prevent seizures seem to be good at turning down the nerve cells which cause the trouble in migraines. According to Dr Goadsby, around 70% of patients with severe migraine can benefit from taking such medicines.

Why this should be is unknown, though the fact that the drugs, which include valproate and gabapentin, act on nerve cells that rely on calcium for part of their communication with each other may be significant. Anti-convulsants, however, are a blunt instrument: they can cause a range of side-effects, including fatigue, hair loss and anxiety.

Hence the search for a more precise weapon—ideally one that finds its targets only in the brain stem. Researchers at Eli-Lilly and GlaxoSmithKline are embarking on trials of drugs aimed at blocking the actions of nerve cells that receive their instructions from “neurotransmitter” molecules called adenosine and glutamate. Crucially, these drugs do not also act on blood vessels, something that has made old-style drugs unpalatable to anybody with heart disease or blood-pressure problems. The end of migraine pain may therefore soon be in sight.

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Protein folding

Moving pictures

Jun 6th 2002
From The Economist print edition

It is now possible to watch a protein molecule folding up

PROTEINS are chains of molecular links known as amino acids. But they are not floppy chains. To do its job, a protein must fold into a precise shape that fits the molecule (often another protein) with which it is supposed to interact in the metabolic ballet that is played out inside a cell.

If a protein misfolds, it will usually just fail to work. Occasionally, though, it will work, but wrongly. Several nasty illnesses, including Creutzfeldt-Jakob disease and Alzheimer's disease, are believed to be caused by misfolded proteins. How a protein folds is therefore a matter of considerable interest. A recent paper in the *Journal of the American Chemical Society* casts some light, quite literally, on the matter.

Julia Lyubovitsky, Harry Gray and Jay Winkler of the California Institute of Technology, in Pasadena, have worked out a way to watch a protein in the act of folding. Their trick is to attach a luminous molecule known as a fluorophore to one end of the amino-acid chain, and then to monitor it using a powerful camera.

Fluorophores, as their name suggests, are fluorescent—in other words, they absorb light and then re-emit it. The researchers provided the necessary illumination with a laser. That meant the fluorophores could be lit up with pulses a mere fifty-trillionths of a second long, catching their host proteins in the fleeting act of folding.

This was possible because the protein under study includes, besides its amino-acid chain, a molecular unit known as heme. Ferricytochrome-c, as this protein is called, is part of the cellular energy-processing apparatus known as the electron-transfer system. But besides handling electrons, heme also absorbs light, and the researchers arranged matters so that the frequency of the light emitted by the fluorophore was exactly that preferred by heme units.

In a folded ferricytochrome-c molecule, the heme is in the middle. So the upshot was that the closer the folding process had brought the fluorophore to the heme, the more likely it was that the emitted light would be absorbed by the heme rather than reaching the camera. The amount of light recorded by the camera therefore tracks the distance between the fluorophore and the heme—and thus the folding pattern of the protein.

Of course, things are more complicated in practice. The ferricytochrome-c molecules have to be held in an unfolded state by dissolving them in a solvent known as a denaturant. They are then forced to fold by rapid mixing with a second solution that neutralises the effects of the denaturant and so promotes the process. The camera is thus photographing lots of ferricytochrome-c molecules simultaneously, and what is recorded is the signal from a distribution of protein molecules that have got to different stages of the folding process. But modern computing techniques can untangle that bundle of data fairly easily—indeed, the multiplicity of molecules involved actually provides extra information. Combined with multiple flashes from the laser, the result can be reconstructed as what is, in effect, a moving picture of how the protein folds.

That picture is not proving as simple as was expected. One significant surprise is that ferricytochrome-c molecules that get their knickers in a twist as they are folding can spontaneously unfold and try again. The significance is that such knowledge might help to design ways of helping other sorts of protein that have not folded correctly, but cannot untangle themselves, to have another go. It is a long way from this observation to a treatment for Alzheimer's. But it may be a step on the road .

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Pruning trees

A biting response

Jun 6th 2002
From The Economist print edition

Elk saliva stimulates plant growth

GARDENERS understand the virtue of pruning. Cutting back the lanky stems of a prized shrub leads not only to a smaller bush, it also reinvigorates the whole plant, thickening it up as side branches are stimulated into growth. Other species of mammal prune plants too—albeit as a side-effect of eating them. Deer, for instance, often browse trees and shrubs, biting off twigs to eat. This is sometimes observed to have the same effect as artificial pruning. In particular, certain species of tree in northern climes seem to produce more shoots in regions where they are browsed by elk. According to Margareta Bergman, of the Swedish University of Agricultural Sciences in Umea, however, this enhancement of growth is more than just the result of animal cutting and tearing. The real stimulus lies in the elk's saliva.

Dr Bergman did her experiments on sallow saplings. She divided her plants into three groups. One group had no treatment. A second had the top branches torn off to mimic the biting action of an elk. The third group suffered the same indignity but, in addition, had elk saliva painted on to the torn surfaces.

After 15 weeks the changes were dramatic. Compared with untreated sallows, cutting on its own produced a 20% increase in the number of new branches grown. Sallows cut and treated with saliva, however, grew 110% more branches.

Which component of elk saliva has this beneficent effect remains to be determined, as does its precise action, but it is probably another case of chemical co-evolution between plants and their herbivorous predators. Poisons are a good example of such co-evolution. If you cannot run away, chemical defences help. But if you do not manage to evolve those, reacting to a molecular signal that tells you that you have been browsed, so you can put on a growth spurt, seems a sensible response. How quickly elk saliva makes its way into the armoury of the average gardener remains to be seen.

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Football books

The world through soccer's eyes

Jun 6th 2002
From The Economist print edition

Reuters

Soccer is at last producing books you do not have to lip-read

Get article background

UNTIL recently there was an informal class division in sports literature in Britain. Much as with baseball in America, it was widely accepted that cricket could produce fine writing—by the likes of Neville Cardus and John Arlott. But books on soccer were generally rubbish: ghost-written pap that was suitable only for diehard fans, who were probably following the text with their fingers.

Things have changed over the past decade. Nick Hornby, one of Britain's best-selling novelists, made his name with “Fever Pitch”, a book about his obsessional support for Arsenal football club. Mr Hornby's book struck a chord with a generation of similarly preoccupied men, and perhaps also with their long-suffering wives. He showed that football could be interesting as much because of the passions it arouses, as because of anything that actually happens on the field of play.

A whole new genre of books followed, which used football as a window on to culture. Simon Kuper's “Football against the Enemy” captured the interplay between football, politics and nationalism; Jimmy Burns's books on Diego Maradona and Barcelona football club were as much about Argentine and Catalan culture as about football; and, to complete this trio of current or former *Financial Times* reporters, Jonathan Birchall used the launch of professional soccer in Japan (in “Ultra Nippon”) as a whimsical way of looking at the country as a whole.

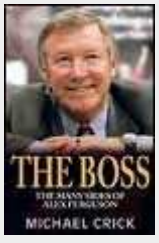
Alex Bellos's book on Brazilian football is a well-written and highly entertaining addition to this growing genre of football travel-writing. The author's ambition is to paint a “portrait of Latin America's largest country seen through its passion for football”. Even more than the Rio carnival or the Amazon, Brazilian football has formed the world's picture of the country; an image of an exotic, joyous, multiracial nation. As Mr Bellos writes: “We love Brazil because of the spectacle. Because their fans are so exuberantly happy...because the national team conveys

Futebol: Soccer the Brazilian Way
By Alex Bellos

Bloomsbury; 407 pages; $25.95 and £9.99

Buy it at
Amazon.com
Amazon.co.uk

The Boss: The Many Sides of Alex Ferguson
By Michael Crick



a Utopian racial harmony." The emergence of yet another flamboyantly talented Brazilian team at this year's World Cup looks certain to prolong the footballing world's love affair with Brazil.

Simon & Schuster; 612 pages; £17.99

Buy it at Amazon.co.uk

Yet, as Mr Bellos shows, football is even more important to Brazil's self-image. The book is not so much a narrative as a series of snapshots of Brazil and its footballing obsession. In an opening chapter that is both amusing and poignant, Mr Bellos visits a couple of the hundreds of Brazilian footballers making their living by playing abroad, in this case in the Faroe Islands; in another he discovers the man who designed Brazil's iconic gold jerseys, who turns out to be a Uruguay supporter. Towards the end, the book takes a more serious turn, as Mr Bellos examines the corrupted state of modern Brazilian football— and what it says about the state of the country in general.

While Mr Bellos's work is a good example of how the new football literature can be both serious and entertaining at the same time, Michael Crick's biography of Sir Alex Ferguson, the legendary manager of Manchester United, the world's richest club, is less successful. The fact that Mr Crick—a well-known investigative journalist and political biographer—should have been commissioned to write over 600 pages on a team manager is itself evidence of the new respectability of football writing. But the result is disappointing. Mr Crick's best work has involved unmasking villains such as Jeffrey Archer, the novelist and Tory politician, who is now in prison for perjury. The difficulty is that Mr Crick is a self-confessed Man-U supporter; and hero-worship does not become him.

Mr Crick is too much of a professional not to do some digging. He suggests, but only in passing, that it was junior coaches as much as Sir Alex who spotted and polished the talent of young players like David Beckham and Ryan Giggs. His portrait of Sir Alex is not especially flattering: he comes over as an evil-tempered bully. Maybe winning managers have to be. Or again, maybe not. Mr Crick does not tell us. Unlike much of the best new football writing, this one is for fans only.

Futebol: Soccer the Brazilian Way.
By Alex Bellos.
Bloomsbury; 407 pages; $25.95 and £9.99

The Boss: The Many Sides of Alex Ferguson.
By Michael Crick.
Simon & Schuster; 612 pages; £17.99

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Biomechanics

Muscular prose

Jun 6th 2002
From The Economist print edition

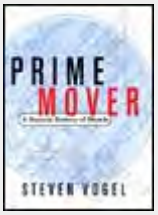
WHAT makes footballers move? There is no shortage of books about how brains work; here is one about brawn. Steven Vogel, a biologist at Duke University, studies biomechanics, a field that looks at biological organisms as machines, from a technologist's perspective. “Prime Mover” is an engaging survey of the engine that powers those machines: muscle. The word itself, Mr Vogel tells us, derives from the Latin for “mouse”—*mus*—by analogy with the mouse-like bulge of muscle that moves when you tense your arm.

The biochemical underpinnings of muscle, and how scientists figured it out, might seem to require heavy lifting from readers, but Mr Vogel's prose is sprightly and readable, and occasionally startling. Muscles produce their greatest force not when shortening, but when trying to resist being lengthened. This was demonstrated at the Royal Society in London in the 1950s, when two bicycle frames were hitched together, so that turning the pedals on one frame forward caused the pedals on the other to go backward. One rider then tried to turn his pedals forward, while another tried to prevent him from doing so; the first rider quickly became exhausted, while the second barely broke a sweat. The same phenomenon explains why walking downhill is so tiring.

Having covered the theory of muscle, Mr Vogel turns to its application. He explains how tools, from can openers to human-powered aircraft, exploit muscle power, and explores the human engine's capacity for running, rowing and carrying. Muscle is also a fuel: Mr Vogel explains why beef is a different colour from chicken, how a restaurant menu reveals an inverse correlation between price and collagen content, and why cannibalism makes no economic sense as a means of food supply. (It would, apparently, require a population to sacrifice an unsustainable two-thirds of its adults each year.) Mr Vogel ends by arguing that bones, tendons and muscles may not be as trendy as genes, but understanding what they are and how they function is just as important. Watch them at work as you cheer those World Cup goals.

Prime Mover: A Natural History of Muscle.
By Steven Vogel.
Norton; 384 pages; $25.95 and £19.95

Prime Mover: A Natural History of Muscle
By Steven Vogel



Norton; 384 pages; $25.95 and £19.95

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About sponsorship

Accusing the IMF

Bad faith

Jun 6th 2002
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Joseph Stiglitz could have written a good book on globalisation. Maybe next time

HERE is an author superbly qualified to write the definitive account of globalisation—its opportunities, its perils and the demands it places on governments. Joseph Stiglitz is an eminent theoretical economist, winner of last year's Nobel Prize. He was chairman of Bill Clinton's council of economic advisers, and chief economist at the World Bank. Yet Mr Stiglitz is no compliant insider. He left the Bank under a cloud after quarrelling with officials in the International Monetary Fund and America's Treasury. Since then he has published a string of articles questioning conventional thinking on development.

So Mr Stiglitz has the knowledge—practical and theoretical—as well as the independence of mind to produce a really outstanding book. The puzzle, then, is how he ever came to write this one.

Forget the title, for a start. This is not a book about globalisation—not considered in the round, at any rate. Mostly, it is an extended assault on the IMF. What the Fund did in Russia during the 1990s, or in East Asia during the crisis of 1997-98, is no small or unimportant matter. But this sets exceedingly narrow limits on the questions the book purports to address.

Globalisation and Its Discontents
By Joseph E. Stiglitz

Norton; 282 pages; $24.95.
Allen Lane; £16.99

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Amazon.co.uk

Where are the chapters on trade and growth, on trade and wages, on trade and unemployment, on global income inequality, on the digital divide, on market forces and the environment, on multinational monopoly, on intellectual property, on migration, on cultural imperialism—on any of the issues, in fact, that most animate the anti-globalist protesters and their far more numerous armchair sympathisers? The merits of globalisation do not rest on whether the Fund was right to call for higher interest rates in East Asia during its attempts to stabilise the region's economies after 1997—the issue that most excites Mr Stiglitz. In fact, these things have almost nothing to do with each other.

Suppose, however, that the book had been more accurately entitled, “The IMF and My Discontent”. How does it measure up against this more modest ambition? Not as well as it should. People interested in the subject will have to read it, certainly: Mr Stiglitz is too good an economist to ignore, and the arguments he advances on the mainly technical matters he addresses have real weight, as you would expect. Yet even as an essay on the failings of the IMF, the book has terrible flaws.

Those who prefer their reading matter to have been edited, for instance, will feel badly let down. Mr Stiglitz's prose reads like a draft dictated to a secretary whose mind was apt to wander: readers too will be drifting off a lot. Also, the narrative conveys a whining self-righteousness that is always tiresome and sometimes downright repellent. The book's dedication thanks the author's parents for teaching him to care. If only others had been taught to care, Mr Stiglitz seems to say, this book would not have been necessary.

And the problem with the knaves at the IMF and the Treasury is not just that they are heartless and incompetent. In an extraordinary paragraph, the book all but accuses Stanley Fischer, the Fund's deputy managing director during the years in question, of corruption: he inflicted needless punishment on borrowing countries, Mr Stiglitz implies, in return for a nice fat job with Citibank, whose interests that policy served. The author himself knows this is rubbish. Mr Fischer—no less eminent an economist than Mr Stiglitz, by the way—is a man of (hitherto) unquestioned integrity, admired right across the profession. With assaults such as these, Mr Stiglitz only shreds his own credibility.

The tasks that were dropped in the IMF's lap during the 1990s—sorting out the East Asian mess, helping Russia move from communism to capitalism—were enormously difficult. Mr Stiglitz often succeeds in laying bare exactly why. In explaining the economic interconnections which frustrated attempted remedies, he is at his impressive best. But the point is, setbacks were inevitable.

Mr Stiglitz appears to think otherwise. What if his advice had been followed? Often, that would have been difficult. He believes for instance that Russia should have established the rule of law before abandoning communism. No doubt—but how useful is it to be told that? It is equally fatuous to suppose that the Fund got things wrong deliberately, or out of stupidity, or because it was just too proud to heed the plainly superior mind of the author. Mr Stiglitz is a brilliant economist—and he cares, he cares. But not even he could have delivered Russia from communism to capitalism without pain.

Globalisation and Its Discontents.
By Joseph E. Stiglitz.
Norton; 282 pages; $24.95.
Allen Lane; £16.99

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About sponsorship

New fiction

True grit

Jun 6th 2002
From The Economist print edition

Two novels explore the other side of the American South

MOONLIGHT and magnolia hardly figure. Nobody sips mint juleps. These are two novels about the obverse side of the American South, the side that is often violent, uncouth, inbred and hostile to outsiders. Frank Manley's “True Hope” is a worthy successor to his first novel, a rite-of-passage story, “The Cockfighter”. It is set mainly in Georgia. Most of the characters are male; the sort of men who chew Red Man tobacco, drive Ford pick-up trucks with outsize wheels, work at chicken-processing plants, live with their childhood sweethearts in mobile homes parked behind pa's hunting shack, dine at restaurants called “Pete's Eats” and bed their good-time girls at EZ-Rest motels.

Justice is crude, and sometimes lethal: “The county was run real tight,” a character says, “and there wasn't much lawlessness in it. People didn't tolerate lawlessness there except when it served a useful purpose, and then it wasn't lawlessness. It was an expression of public opinion.”

The hero of “True Hope”, Al Cantrell, re-enters this world after spending nearly two years in prison at Reidsville for assault and battery. He was, we read, driven to drink, violence and jail by the death of his beloved wife Kate. Now near 40, he is determined to grow up, go straight and find somebody or something worth living for. As Al seeks to restore sense to his life he is knocked off balance time and again by low-life southerners. By Bubba Jones, the self-serving do-gooder at the House of Hope. By Benny, a corrupt political boss, a pint-sized version of Willie Stark in “All the King's Men”. By Tom, his mad and bad father-in-law, a pyromaniacal Korean war veteran. By Laurie, a winsome but utterly amoral sexpot.

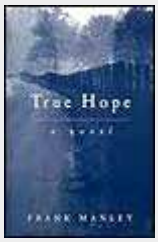
These subsidiary characters are so strong and so colourful that they often threaten to eclipse Mr Manley's comparatively passive Al, just as Inman, the hero of Charles Frazier's confederate bestseller, “Cold Mountain”, was upstaged by its under-cast. If weakness in Al is a fault, it is forgivable in a fine novel of stark, spare prose.

The plot is more gothic, the prose riper in John Biguenet's “Oyster”. But then this immoderation befits a story set in the sweaty bayous of Louisiana, where economic decline has intensified a blood feud between two once affluent oyster-farming families, the Petitjeans and Bruneaus. Hatred, often complicated by love or lust, leads to murder. All think they know who the killers are but nobody is saying. Enjoyment of the novel is much increased by Mr Biguenet's detailed knowledge of the oyster trade, which he passes on to his readers, and of Cajun culture. Regional words add flavour: gris gris, batture, nutria, mirlitons.

These two books, so different in style, share a common virtue. Neither condescends, still less sneers, at people often stigmatised as poor white trash. Mr Manley and Mr Biguenet strive rather to understand the lives and hopes of underclass whites in the Deep South, losers in a country that abhors failure. Both succeed.

True Hope.
By Frank Manley.

True Hope
By Frank Manley



Carroll & Graf; 320 pages; $25

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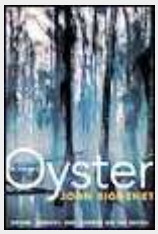
OYSTER
By John Biguenet and Janette Turner Hospital



Ecco; 304 pages; $23.95.
Allen Lane; £16.99
Norton; 400 pages; $25.95.
Orion; £12.99
Virago; £14.99

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Carroll & Graf; 320 pages; $25

Oyster.
By John Biguenet.
Ecco; 304 pages; $23.95. Allen Lane; £16.99
Allen Lane; £16.99

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New fiction

Airport reading

Jun 6th 2002
From The Economist print edition

AIR passengers are not the only ones to be nervous at the thought of crashing. The manuscript for “Free Fall” was still out for consideration at a number of New York houses when the World Trade Centre was hit last September. Its main character is the daughter of a woman who dies in a plane that plummets into Long Island Sound—just as TWA Flight 800 did in 1996. In the recoil from fiction that seems to exploit air disasters, Jenefer Shute has yet to find a Manhattan publisher.

This queasiness is a pity. “Free Fall” is an affecting and unusually disciplined novel. It resists imposing a grander narrative on the crash, sticking loyally to the pain and numbing tedium of its aftermath: official briefings, airline grief counsellors, poignant encounters with other bereaved relatives who are at once intimates and total strangers. Gathered in an airport hotel, everyone awaits the slow recovery of remains: a shirt; a foot.

Free Fall
By Jenefer Shute

Secker & Warburg; 287 pages; £10.99

Buy it at
Amazon.co.uk

The characters here are on a realistic scale (“Life-Size” was the title of Ms Shute's first novel). Eleanor, the narrator's dead mother, was a nervous, disappointed woman from South Africa “who would have wanted to stick around, if only for the meagre satisfaction of being right, of confirming that things had turned out as dismally as she'd expected.” At the wheel of a car she would creep along “with the spasmodic, freeze-frame motion of a frightened squirrel, braking abruptly for perceived threats”. Her daughter Kim—like the author, a South African expatriate living in New York—wonders if “after all those years of bracing for the smash that never came, she'd died silent, surprised, her mouth stretched into a mute O”.

Kim's and Eleanor's relationship was lousy in that squalid, gratuitous way that many mothers and daughters would recognise. Their affection ever inchoate, they fought incessantly and wastefully, but less over meaty matters like apartheid than over trifles. And Ms Shute obeys what must be a universal law: that death never leaves such relationships in a state of grace. If your mother ever does hurtle into the sea, count on the fact that the last thing you will have said to her was horrid.

Ms Shute is used to controversy. At 22 she was exiled for anti-apartheid work, and allowed back into South Africa only in 1991. “Life-Size” broke the fictional ice on eating disorders, inaugurating a genre dubbed “Anorexia Lit”. Her second novel, “Sex Crimes”, whose main character blinds her own boyfriend, was so edgy that the publisher redid the American cover to make it seem more ladylike. In all three books, Ms Shute has defied received wisdom by creating narrators who are often deeply unattractive.

Why, she wonders, shouldn't fiction about terrorism or air crashes “create an echo chamber for people to address their own experience”? Why not explore catastrophe's personal consequences imaginatively? In face of horror, it is natural to hide our eyes. But fiction offers bolder possibilities, at least when it is not, in Philip Larkin's phrase, a frieze of grief. Ms Shute's remarkable book passes that simple test.

Free Fall.
By Jenefer Shute.
Secker & Warburg; 287 pages; £10.99

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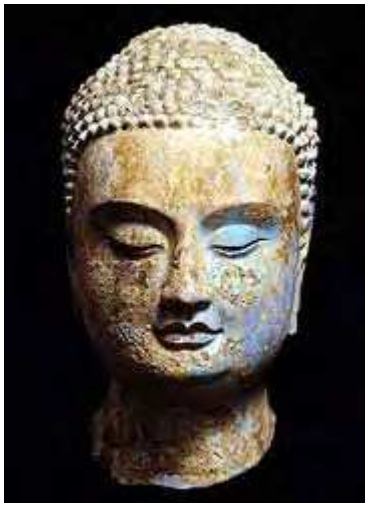
About sponsorship

Chinese archaeology

The beautiful mysteries of Qingzhou

Jun 6th 2002
From The Economist print edition

A dazzling show of Buddhist art from China has unleashed a controversy



Enigmatic

ARCHAEOLOGY can be a dirty business in more ways than one. No sooner had an exhibition of hitherto unseen Chinese Buddhist sculptures from the sixth century AD opened at the Royal Academy in London than the official story of their discovery was called into question. Most of the press praised the breathtaking beauty of the unknown masterpieces from Qingzhou. Scholars hailed the exhibition as a revelation of the link between Indian and Chinese art. Comparing the Qingzhou sculptures to the statues at Chartres, the catalogue saw them as marking a transition: from the static, indigenous style of the Wei dynasties to a more naturalistic treatment of human form in the works made for the nomadic rulers of the Northern Qi dynasty, who prized Indian culture. But Souren Melikian, an experienced arts-and-salesroom writer for the *International Herald Tribune*, thought it all sounded suspiciously neat.

The strange facts are these. In 1996, workers clearing a sports field for a school in Qingzhou stumbled across the head of a Buddha. This led them to a pit below, filled with over 400 sculptures: dozens of broken heads and hands and over 200 virtually intact torsos, many of exceptional condition and quality, in several styles and with unusually well-preserved gilding and paint. A Buddhist temple had once occupied the site and Qingzhou was an ancient stronghold of the religion that had spread from India. But why had the statues been broken in such a way, with heads and hands surrounding larger, life-size pieces? When and why did the monks inter these sculptures and why with such apparent care, padding them with reed mats and sprinkling coins in the mass grave?

The sculptures themselves offer few clues. They were created between 529 and 577, while the scattered coins date from the Song Dynasty in the early 12th century, a time of persecution against Buddhists. Some show fire or earthquake damage, and may have been buried when they became too damaged for their holy function. Others show signs of violence and may have been broken during the Buddhist persecutions. No one knows for certain, and in the race to excavate the works before looters could attack, local archaeologists cleared the site in ten days, neglecting to take stratigraphic surveys or a complete photographic record of the pit. The site was then paved over for the sports field.

After seeing this extraordinary show, Mr Melikian wrote an inflammatory review, insinuating that the discovery could have been a hoax. He found it strange that so many mainly sixth-century sculptures should have been buried 400-500 years later, supposedly as a sign of respect. Were they all interred so long ago? He was suspicious of the neat breaks in some of the sculptures, which preserved their heads, hands and saleable features intact, and which he likened to breaks made by looters when dividing up pieces among themselves. Finally he went for the jugular: “This is disturbingly suggestive of Cultural Revolution-style vandalism peppered with opportunist commercial initiatives.”

Robust denials

Mr Melikian's suggestions of foul play were rejected by everyone close to the exhibition, as well as by scholars in the field, such as Professor Roderick Whitfield of London University's School of Oriental and African Studies. Norman Rosenthal, exhibitions secretary of the RA, insisted there was no reason to question the authenticity of the statues or of the dig. Many of the sculptures in the pit had been broken in ways that did not preserve their heads or hands, but these were too damaged to show. Money from

the show, which also toured Berlin and Zurich, will help build a museum in Qingzhou to exhibit the sculptures permanently. He noted also that the Chinese have archaeological treasures “coming out of their ears”, so why bother to fake them?

One of the foremost Asian antiquities dealers, Giuseppe Eskenazi, who helped organise the show and who owns a gallery off London's Bond Street, is widely respected as knowing the field. He wondered how anyone could transport and hide 400 sculptures undetected, some weighing more than a tonne, during the upheavals of the Cultural Revolution. And if these works were intact in the late 1960s or early 1970s and then buried, why is not one of them recorded? “I visited China three times during that period and such events did not occur. People were smashing art rather than preserving it,” Mr Eskenazi says.

The dig troubled some, including Lukas Nickel, a Zürich-based archaeologist who edited the catalogue and visited the site. But he claimed that rescue operations of this nature are not unusual in a country where there is still more art underground than overground, and where archaeologists must battle the twin threats of rampant development and violent looting. In addition, he believes full details will emerge when the excavation paper is published later this year.

Edmund Capon, an expert in early Buddhist sculpture who heads the Gallery of New South Wales in Australia, adds a surprising twist, however. The first scholarly mention of the Qingzhou works was in 1997, unusually soon after the reported find. That same year in Taiwan, Mr Capon saw sculptures from private collections at a show in the National Palace Museum, Taipei. He is convinced they had come from the Qingzhou pit. Had some of the Qingzhou statues, excavated earlier than 1996, found their way on to the market?

To add to the puzzle, in 1988 Mr Capon bought for his museum a Buddhist sculpture of the Eastern Wei period, which dates from 535-40 and is exceptionally close to the style, material and quality of the Qingzhou sculptures. Might some of the oddities in the story of the 1996 discovery have arisen in an effort to construct a compelling picture of a single, dramatic event—the sudden opening of this magnificent treasure trove—whereas the truth was a slower, more ragged recovery, with all the possibilities of bribery and theft? Outsiders may never know. China is a large place in which archaeologists commonly use armed guards to protect sites from looters.

The mystery surrounding the discovery of the Qingzhou Buddhas will no doubt continue to be debated. But this should not blind us to the miracle that so many sculptures of this age and beauty have survived to dazzle our eyes. You still have until July 14th at the Royal Academy in London to see for yourself.

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About sponsorship

Genichi Kawakami

Jun 6th 2002
From The Economist print edition

Genichi Kawakami, the “emperor” of Yamaha, died on May 25th, aged 90

Nippon News/Yamaha

IN THE 1970s, Steinway, perhaps the grandest of America's piano makers, became alarmed at the success of Asian competitors, notably Yamaha of Japan. Yamaha offered well-made pianos at much lower prices than American ones. Several American manufacturers were unable to stand the competition and closed down. Yamaha's president, Genichi Kawakami, having captured an enviable slice of the American market, was now after a more elusive prize: the sort of status that went with a Steinway piano. And not just equal status. Mr Kawakami predicted that a Yamaha would eventually come to be regarded in the United States and Europe as the piano of choice.

Steinway's strategy was not to let its worries show. “A Steinway is a Steinway,” said John Steinway, whose family had been making pianos since 1853. The simple, if pompous, pronouncement seemed to strike a faultless chord with its traditional public for whom a grand piano was a necessary icon, whether or not anyone in the family could play it; and, even more distressing to Mr Kawakami, it made sense to ambitious Americans who hoped one day to have a home graced with their own grand piano as a symbol of high achievement and cultural taste.

Mr Kawakami could also play the history game. He pointed out that his firm had been started in 1887 by Torakusu Yamaha. A Yamaha piano and organ won a prize at the St Louis World Fair in 1904. Mr Kawakami's father became president of the firm in 1927. Ten years later Mr Kawakami joined the firm and subsequently took command, adding many other products, notably motorbikes (now made by a separate company), to the Yamaha brand, and passing the baton to his son Hiroshi in 1983. Three generations in the same family. It was, declared Mr Kawakami, like a symphony in three movements. Americans enjoyed the tussle of the giants, but Steinway's reputation remained defiantly intact.

The mystery

Genichi Kawakami was sure that Yamaha pianos sounded every bit as good as the American product. Indeed, he was assured by his experts that they were superior. But this mysterious quality, status, has bewildered, and irritated, many Japanese manufacturers who set out to take on the world. Japanese cameras are among the finest you can get, used by professionals the world over. Yet, for your ordinary rich Japanese Germany's Leica carries the real prestige. If you can lay your hands on an early one (the miniature camera was invented by Leica in 1925), so much the better. Japanese cars are known for their reliability and style, but a Mercedes or a Rolls, polished until it glows like an old painting, still has the edge. Who would prefer a cumbersome Harley-Davidson motorbike to a slim, racy Japanese model, a Yamaha perhaps? Quite a lot of people.

Mr Kawakami's worries over status may have cast a cloud over a career that in every other way was extraordinarily successful. He was one of the tycoons who helped to make Japan's economy the second largest in the world. The beginnings were modest. The firm that he took charge of in 1950 made pianos, mouth-organs and wind-up gramophones. It had a respected name in Japan, but not much else in the way of assets. The Japanese were too busy rebuilding their ruined country after the second world war to indulge much in such luxuries.

In 1953 Mr Kawakami toured the United States and Western Europe. He observed that the victorious countries were prospering and spending happily, although perhaps not happily enough to buy a wind-up

gramophone, however carefully made. In the culture of the jukebox, even the piano seemed old-fashioned. Playing the piano was something that parents might do, but not their children.

Mr Kawakami decided that to sell his pianos in any number he first had to create a new market. “Put yourself in the shoes of the user and build world-class products,” he said. It was a statement of the obvious; what was special was that, in marketing Yamaha pianos, Mr Kawakami pursued the obvious with great tenacity. In 1954 in Hamamatsu, where his factory was located, he started a class to teach the rudiments of music to young children. This evolved into a worldwide chain of franchised schools of music, many with a showroom for Yamaha musical instruments. More than 5m students are reckoned to have passed through the schools. By the late 1980s, Yamaha had become the world's leading maker of musical instruments of all kinds, not just pianos. In Japan alone, Yamaha had 55% of the piano market. In a country of mostly minute homes, Mr Kawakami was able to persuade many Japanese that a piano was a necessity.

He never seemed to stop. “Diversification was his hobby,” Mr Kawakami's son remarked. “He got bored with old businesses.” During the 33 years Mr Kawakami ran the firm either as president or “supreme adviser” he kept boredom at bay by expanding Yamaha into all kinds of products. These days, along with Yamaha pianos and motorbikes, there are water scooters, tennis rackets, golf clubs, machine tools. Japanese newspapers called him the “emperor” of Yamaha. Genichi Kawakami quite liked that.

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Overview

Jun 6th 2002
From The Economist print edition

International investors are losing their appetite for the American **dollar**. It fell this week to a 17-month low of $0.94 against the euro—a loss of 9% since February. Wall Street also continued to slide: the S&P 500 fell to its lowest point since October, leaving it 32% below its peak in March 2000.

The financial markets shrugged off new evidence of economic recovery. The University of Michigan's index of consumer sentiment rose in May to its highest level since December 2000. In the same month, the ISM index of manufacturing activity rose to its highest level in over two years. Business activity in non-manufacturing sectors also rose to its strongest rate since August 2000.

Average inflation in the **euro area** fell to 2.0% in May, just inside the ECB's target of 2% or less. Unemployment in the euro area fell to 8.3% in April. Real GDP grew by 0.9% at an annual rate in the first quarter; output was only 0.1% higher than a year ago.

The **Canadian dollar** fell on news that Paul Martin, the country's finance minister, had been sacked. But the currency bounced back after the Bank of Canada raised its overnight interest rate by a quarter-point to 2.5%. Canada's GDP grew at an annual rate of 6.0% in the first quarter.

Australia's GDP rose by 4.2% in the year to the first quarter—by far the biggest increase of any country in our table.

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Economic forecasts

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From The Economist print edition

Each month *The Economist* surveys a group of forecasters and calculates the average of their predictions for economic growth, inflation and current-account balances for 15 countries and for the euro area. The table also shows the highest and lowest projections for growth. The previous month's forecasts, where different, are shown in brackets. This month the panel has revised up its forecast for growth in America in 2002 to 2.9%. This is more than twice as fast as the 1.3% growth pencilled in for the euro area. Australia's growth in 2002 has been revised up by even more, to 4.0%. Australia is also tipped to top the league in 2003, with growth of 3.9%, followed closely by Canada (3.6%) and the United States (3.5%). The panel has increased its inflation forecasts for this year in 11 of the 15 economies. Japanese prices are expected to continue to fall this year and next.

The Economist poll of forecasters, June averages (previous month's, if changed)

	Real GDP, % change				Consumer prices % increase		Current account % of GDP	
	Low/high range		average					
	2002	2003	2002	2003	2002	2003	2002	2003
Australia	2.8/4.9	3.5/4.4	4.0 (3.8)	3.9	2.6 (2.5)	2.5	−3.5(−3.6)	−3.6 (−3.7)
Austria	1.1/1.7	2.1/3.4	1.3	2.7	1.7	1.7	−2.2	−2.0
Belgium	0.5/2.6	2.6/3.9	1.4	3.1	2.0 (1.9)	1.7	5.1 (4.8)	5.3 (4.8)
Britain	1.2/2.2	2.4/3.8	1.8 (1.9)	3.0 (2.9)	2.1	2.5	−2.2(−2.1)	−2.1
Canada	2.1/3.4	3.0/4.8	2.9 (2.7)	3.6 (3.5)	1.5	2.1 (2.0)	2.2 (2.1)	2.5 (2.3)
Denmark	1.2/1.9	2.0/3.0	1.6	2.5	2.4 (2.1)	2.1	1.9 (2.2)	1.9 (2.0)
France	1.2/1.7	2.6/3.5	1.4 (1.5)	2.9	1.8 (1.6)	1.5	1.7	1.7
Germany	0.6/1.4	1.8/3.7	0.9 (1.0)	2.7 (2.6)	1.6 (1.5)	1.4	0.7 (0.4)	0.8 (0.4)
Italy	1.0/1.8	2.0/3.6	1.3 (1.4)	2.9	2.2 (2.0)	2.1 (2.0)	0.1	nil
Japan	−1.3/0.4	0.3/1.7	−0.8 (−1.0)	1.2 (1.1)	−0.9 (−1.0)	−0.6	2.6 (2.5)	2.6
Netherlands	0.9/1.8	2.5/3.4	1.4 (1.5)	2.9 (3.0)	3.6 (3.3)	2.5	3.7	4.0
Spain	2.0/2.5	2.8/4.0	2.2 (2.1)	3.3	3.1 (2.5)	2.6 (2.4)	−2.1(−2.2)	−1.8
Sweden	1.4/2.4	2.7/3.2	1.8	3.0	2.4	2.1	3.1 (2.5)	3.2 (2.8)
Switzerland	0.5/1.9	1.8/2.9	1.1	2.3	0.8 (0.7)	1.2 (1.1)	9.7 (9.5)	9.9 (9.6)
United States	2.4/3.3	2.5/4.3	2.9 (2.8)	3.5	1.6 (1.5)	2.3	−4.2	−4.5 (−4.4)
Euro area	1.0/1.5	2.4/3.7	1.3	2.9	2.1 (1.9)	1.8 (1.7)	0.3	0.4

Sources: ABN Amro, Deutsche Bank, Economist Intelligence Unit, Goldman Sachs, HSBC Securities, KBC Bank, Merrill Lynch, J.P. Morgan Chase, Morgan Stanley, Nordbanken, Decision Economics, BNP Paribas, Royal Bank of Canada, Schroder Salomon Smith Barney, Scotiabank, Shinsei Bank, UBS Warburg

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Output, demand and jobs

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From The Economist print edition

% change at annual rate

	GDP		The Economist poll GDP forecasts		Industrial production	Retail sales (volume)	Unemployment % rate	
	1 qtr	1 year	2002	2003	latest	latest	latest	year ago
Australia	+ 3.6	+ 4.2 Q1	+ 4.0	+ 3.9	+ 2.5 Q4	+ 5.0 Q1	6.3 May	6.8
Austria	– 0.7	– 0.4 Q4	+ 1.3	+ 2.7	– 3.1 Mar	+ 1.0 Feb	4.0 Apr	3.4
Belgium	+ 2.0	– 0.3 Q1	+ 1.4	+ 3.1	–10.8 Mar	+ 6.6 Feb	10.4 May*	10.0
Britain	nil	+ 1.0 Q1	+ 1.8	+ 3.0	– 5.9 Mar	+ 6.9 Apr	5.1 Mar†	5.1
Canada	+ 6.0	+ 2.1 Q1	+ 2.9	+ 3.6	– 0.6 Mar	+ 5.4 Mar	7.6 Apr	7.0
Denmark	+ 1.4	+ 1.1 Q1	+ 1.6	+ 2.5	nil Mar	+ 2.1 Feb	5.0 Mar	5.4
France	+ 1.4	+ 0.3 Q1	+ 1.4	+ 2.9	– 0.4 Mar	– 0.1 Mar	9.1 Apr	8.6
Germany	+ 0.7	– 1.2 Q1	+ 0.9	+ 2.7	– 3.2 Mar	– 4.5 Mar	9.6 Apr‡	9.4
Italy	+ 0.6	+ 0.1 Q1	+ 1.3	+ 2.9	– 7.6 Mar	+ 0.5 Mar	9.0 Jan	9.8
Japan	– 4.8	– 1.9 Q4	– 0.8	+ 1.2	– 6.1 Apr	– 4.3 Mar	5.2 Apr	4.8
Netherlands	nil	nil Q1	+ 1.4	+ 2.9	– 5.6 Apr	+ 0.8 Feb	2.2 Apr§	2.0
Spain	+ 2.1	+ 2.0 Q1	+ 2.2	+ 3.3	– 9.3 Mar	na	11.3 Apr**	10.6
Sweden	+ 1.4	+ 1.1 Q4	+ 1.8	+ 3.0	+ 1.6 Mar	+ 4.3 Mar	3.8 Apr*	3.7
Switzerland	+ 0.7	+ 0.2 Q1	+ 1.1	+ 2.3	– 1.0 Q4	+ 0.9 Mar	2.5 Apr*	1.7
United States	+ 5.6	+ 1.5 Q1	+ 2.9	+ 3.5	– 2.0 Apr	+ 5.7 Apr	6.0 Apr	4.5
Euro area	+ 0.9	+ 0.1 Q1	+ 1.3	+ 2.9	– 2.9 Mar	+ 2.0 Mar	8.3 Apr**	8.0
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*							
Finland	– 1.8	– 0.9 Q4	na	na	+ 6.8 Apr	+ 1.9 Feb	10.4 Apr*	10.3
Greece	na	+ 3.7 Q4	na	na	– 2.0 Feb	+ 8.4 Jan	na	na
Iceland	na	+ 3.12001	na	na	+ 3.3 2001	na	2.6 Apr*	1.6
Ireland	na	nil Q4	na	na	+14.7 Mar	+ 0.1 Mar	4.2 Apr	3.6
Luxembourg	na	+ 3.52001	na	na	+ 2.4 Feb	+ 5.4 Dec	2.8 Mar	2.6
New Zealand	+ 2.6	+ 2.9 Q4	na	na	+ 3.5 Q4	+ 8.2 Q1	5.3 Q1	5.4
Norway	+ 1.0	+ 1.8 Q4	na	na	– 2.5 Mar	+ 3.9 Apr	4.1 Q1	3.7
Portugal	+ 1.8	+ 1.0 Q4	na	na	+ 2.3 Mar	– 0.4 Mar	4.4 Q1*	4.2

*Not seasonally adjusted. †Jan-Mar; claimant count rate 3.2% in Apr. ‡EU harmonised rate 8.1% in Apr. §Feb-Apr. **Revised series.

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Prices and wages

Jun 6th 2002
From The Economist print edition

% change at annual rate

	Consumer prices			The Economist poll consumer prices forecast		Producer prices			Wages/earnings		
	latest		year ago	2002	2003	latest		year ago	latest		year ago
Australia	+ 2.9	Q1	+ 6.0	+ 2.6	+ 2.5	+ 0.5	Q1	+ 5.2	+ 4.3	Q1	+ 5.6
Austria	+ 1.8	Apr	+ 3.0	+ 1.7	+ 1.7	– 0.5	Apr	+ 2.9	+ 2.4	Apr	+ 2.6
Belgium	+ 1.3	May	+ 3.1	+ 2.0	+ 1.7	+ 1.4	Apr	+ 3.3	+ 3.1	Q1	+ 1.9
Britain	+ 1.5	Apr	+ 1.8	+ 2.1	+ 2.5	+ 0.2	Apr	+ 0.6	+ 2.9	Mar	+ 5.0
Canada	+ 1.7	Apr	+ 3.6	+ 1.5	+ 2.1	– 1.5	Apr	+ 2.7	+ 3.3	Mar	+ 1.2
Denmark	+ 2.4	Apr	+ 2.7	+ 2.4	+ 2.1	+ 0.3	Apr	+ 3.6	+ 4.1	Q4	+ 3.8
France	+ 2.0	Apr	+ 1.8	+ 1.8	+ 1.5	– 0.7	Apr	+ 3.0	+ 3.9	Q1	+ 4.3
Germany	+ 1.2	May	+ 3.5	+ 1.6	+ 1.4	– 0.5	Apr	+ 4.1	+ 2.4	Mar	+ 1.6
Italy	+ 2.3	May	+ 3.0	+ 2.2	+ 2.1	– 1.2	Apr	+ 4.3	+ 2.6	Apr	+ 2.6
Japan	– 1.1	Apr	– 0.7	– 0.9	– 0.6	– 0.7	Apr	+ 1.3	+ 0.1	Apr	+ 0.1
Netherlands	+ 3.6	Apr	+ 4.9	+ 3.6	+ 2.5	– 1.8	Mar	+ 5.7	+ 3.1	Apr	+ 4.6
Spain	+ 3.6	Apr	+ 4.0	+ 3.1	+ 2.6	+ 0.8	Apr	+ 2.8	+ 3.7	Q4	na
Sweden	+ 2.5	Apr	+ 2.8	+ 2.4	+ 2.1	– 0.7	Apr	+ 3.3	+ 4.0	Mar	+ 3.4
Switzerland	+ 0.6	May	+ 1.8	+ 0.8	+ 1.2	– 1.5	Apr	+ 0.9	+ 2.5	2001	+ 1.3
United States	+ 1.6	Apr	+ 3.3	+ 1.6	+ 2.3	– 2.0	Apr	+ 3.7	+ 3.4	Apr	+ 4.3
Euro area	+ 2.0	May	+ 3.4	+ 2.1	+ 1.8	– 0.7	Apr	+ 4.2	+ 3.0	Q4	+ 2.5
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*										
Finland	+ 1.8	Apr	+ 2.9	na	na	– 1.0	Apr	+ 2.9	+ 4.6	Q4	+ 5.0
Greece	+ 3.8	Apr	+ 3.5	na	na	+ 3.7	Mar	+ 4.3	na		na
Iceland	+ 5.9	May	+ 5.5	na	na	+ 7.4	May	+ 5.7	+ 8.0	Apr	+ 9.2
Ireland	+ 4.8	Apr	+ 5.6	na	na	+ 1.0	Apr	+ 3.1	+ 8.1	Q4	+ 6.4
Luxembourg	+ 2.1	Apr	+ 2.8	na	na	– 3.0	Mar	+ 3.9	+ 3.1	Feb	+ 4.8
New Zealand	+ 2.6	Q1	+ 3.1	na	na	+ 2.8	Q1	+ 8.0	+ 2.1	Q1	+ 1.8
Norway	+ 0.5	Apr	+ 3.8	na	na	– 4.7	Apr	+ 9.8	+ 4.6	Q1	+ 4.4
Portugal	+ 3.6	Apr	+ 4.5	na	na	– 1.5	Apr	+ 3.2	na		na

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Money and interest rates

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	Money supply* % change on year ago			Interest rates % p.a. (Jun 5th 2002)					
				3-mth money market		2-year	10-year gov't bonds		corporate
	narrow	broad		latest	year ago	gov't bonds	latest	year ago	bonds
Australia	– 1.3	+15.7	Apr	5.10	4.95	5.88	6.29	6.00	7.33‡
Britain	+ 8.0	+ 5.7	Apr	4.14	5.16	4.72	5.21	5.05	6.17
Canada	+12.8	+ 5.7	Apr	2.68	4.30	4.14	5.55	5.71	6.97
Denmark	+ 7.3	+ 8.2	Apr	3.65	5.00	4.42	5.34	5.27	6.98
Japan	+32.6	+ 3.6	Apr	0.02	0.01	0.06	1.36	1.22	1.47
Sweden	+ 6.4	+ 7.4	Jan	4.29	4.03	5.04	5.54	5.23	5.64
Switzerland	+ 5.5	+ 3.4	Apr	1.25	3.15	2.13	3.29	3.43	4.21
United States	+ 5.8	+ 8.3	Apr	1.79	3.94	3.13	5.04	5.25	6.92
Euro area†	+ 6.9	+ 7.5	Apr	3.47	4.45	4.20	5.06	4.97	5.84

*Narrow: M1 except Britain and Sweden M0, broad: M2 or M3 except Britain M4. †Germany for bonds. ‡New series. Benchmarks: US 30-year 5.66%, Japan No.239 1.40%. Central bank rates: US fed funds 1.75%, ECB refinancing 3.25%, BOJ overnight call 0.001%, BOE repo 4.00%. Sources: Commerzbank, Danske Bank, J.P. Morgan Chase, Royal Bank of Canada, Stockholmsbörsen, UBS Warburg, DRI-WEFA, Westpac, Thomson Datastream. Rates cannot be construed as banks' offers.

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Stockmarkets

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From The Economist print edition

Market indices

	Jun 5th	2002 high	2002 low	% change on one week	% change on record high	% change on Dec 31st 2001 in local currency	% change on Dec 31st 2001 in $ terms
Australia (All Ordinaries)	3,303.6	3,440.0	3,252.2	– 0.9	– 4.0	– 1.7	+ 9.6
Austria (ATX)	1,286.1	1,357.2	1,114.4	– 2.5	–26.0	+12.8	+18.8
Belgium (Bel 20)	2,646.7	2,899.8	2,622.4	– 3.8	–28.1	– 4.9	+ 0.2
Britain (FTSE 100)	4,989.1	5,323.8	4,989.1	– 1.8	–28.0	– 4.4	– 4.4
Canada (Toronto Composite)	7,547.9	7,958.1	7,418.1	– 0.8	–33.7	– 1.8	+ 2.0
Denmark (KBX)	214.4§	233.4	213.3	nil	–28.9	– 4.6	+ 0.5
France (SBF 250)	2,728.9	3,081.9	2,694.1	– 5.2	–37.8	– 8.5	– 3.6
(CAC 40)	4,079.5	4,688.0	4,065.9	– 5.9	–41.1	–11.8	– 7.1
Germany (Xetra DAX)	4,624.3	5,462.6	4,624.3	– 5.3	–42.7	–10.4	– 5.6
Italy (BCI)	1,335.1	1,513.0	1,335.1	– 4.4	–38.8	– 6.9	– 1.9
Japan (Nikkei 225)	11,663.9	11,979.9	9,420.9	– 1.6	–70.0	+10.6	+16.3
(Topix)	1,116.3	1,139.4	922.5	– 0.8	–61.3	+ 8.2	+13.7
Netherlands (AEX)	463.0	531.2	462.6	– 5.4	–34.0	– 8.6	– 3.8
Spain (Madrid SE)	785.0	848.1	773.2	– 3.7	–31.5	– 4.8	+ 0.3
Sweden (Affarsvarlden Gen)	189.1	236.8	189.1	– 3.0	–52.8	–18.3	–12.1
Switzerland (Swiss Market)	6,400.1	6,694.1	6,105.2	– 3.0	–23.9	– 0.3	+ 5.5
United States (DJIA)	9,796.8	10,635.3	9,618.2	– 1.3	–16.4	– 2.2	– 2.2
(S&P 500)	1,049.9	1,172.5	1,040.7	– 1.7	–31.3	– 8.6	– 8.6
(Nasdaq Comp)	1,595.3	2,059.4	1,562.6	– 1.8	–68.4	–18.2	–18.2
Europe (FTSE Eurotop 300)*	1,137.3	1,279.7	1,137.3	– 3.7	–33.3	– 9.8	– 5.0
Euro area (FTSE Ebloc 100)*	971.7	1,125.1	969.6	– 5.2	–37.3	–12.6	– 8.0
World (MSCI)†	949.0	1,024.4	937.0	– 2.2	–34.5	na	– 5.4
World bond market (Salomon)‡	461.2	462.8	430.3	+ 0.3	+ 0.3	na	+ 4.9

*In euro terms. †Morgan Stanley Capital International index includes individual markets listed above plus eight others, in dollar terms. ‡Salomon Smith Barney World Government Bond Index, total return, in $ terms. §Jun 4th.

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Trade, exchange rates and budgets

Jun 6th 2002
From The Economist print edition

	Trade balance*, $bn latest 12 months		Current account $bn latest 12 mths		The Economist poll % of GDP, forecast 2002	2003	Exchange rate trade-weighted† Jun 5th	year ago	Currency units per $ Jun 5th	year ago	per £	per euro	per ¥100	Budget balance % of GDP 2002‡
Australia	+ 1.0	Apr	− 9.5	Q1	− 3.5	− 3.6	78.2	72.5	1.75	1.95	2.55	1.64	1.41	0.1
Austria	− 3.0	Feb	− 2.8	Mar	− 2.2	− 2.0	100.7	99.6	1.07	1.18	1.55	–	0.86	-0.3
Belgium	+ 11.5	Mar	+ 13.0	Dec	+ 5.1	+ 5.3	99.8	98.0	1.07	1.18	1.55	–	0.86	nil
Britain	− 48.0	Mar	− 25.1	Q4	− 2.2	− 2.1	103.2	106.6	0.69	0.72	–	0.64	0.55	-0.8
Canada	+ 36.2	Mar	+ 14.7	Q1	+ 2.2	+ 2.5	77.9	79.1	1.54	1.53	2.24	1.44	1.23	1.0
Denmark	+ 7.0	Mar	+ 3.4	Mar	+ 1.9	+ 1.9	102.7	100.9	7.93	8.81	11.5	7.43	6.36	2.2
France	+ 5.4	Mar	+ 23.6	Mar	+ 1.7	+ 1.7	102.6	100.5	1.07	1.18	1.55	–	0.86	-2.0
Germany	+ 92.3	Mar	+ 13.3	Mar	+ 0.7	+ 0.8	99.6	97.2	1.07	1.18	1.55	–	0.86	-2.8
Italy	+ 8.9	Mar	+ 1.5	Feb	+ 0.1	nil	73.1	71.7	1.07	1.18	1.55	–	0.86	-1.4
Japan	+ 72.6	Mar	+ 96.1	Mar	+ 2.6	+ 2.6	132.4	142.9	125	120	181	117	–	-8.0
Netherlands	+ 22.9	Mar	+ 13.6	Q1	+ 3.7	+ 4.0	98.8	96.8	1.07	1.18	1.55	–	0.86	0.1
Spain	− 37.9	Feb	− 15.8	Feb	− 2.1	− 1.8	74.8	73.5	1.07	1.18	1.55	–	0.86	-0.3
Sweden	+ 14.0	Apr	+ 7.4	Mar	+ 3.1	+ 3.2	77.1	74.6	9.7	10.9	14.2	9.14	7.82	2.1
Switzerland	+ 2.1	Apr	+ 24.6	Q4	+ 9.7	+ 9.9	113.3	107.1	1.57	1.80	2.28	1.47	1.26	na
United States	−421.4	Mar	−417.4	Q4	− 4.2	− 4.5	116.9	120.4	–	–	1.46	0.94	0.80	-1.0
Euro area	+ 58.9	Mar	− 2.0	Mar	+ 0.3	+ 0.4	80.9	76.2	1.07	1.18	1.55	–	0.86	-1.5
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*													
Finland	+ 12.4	Mar	+ 7.5	Mar	na	na	78.7	77.2	1.08	1.18	1.57	–	0.87	3.2
Greece	− 19.1	Dec	− 7.2	Dec	na	na	57.9	56.9	1.08	1.18	1.57	–	0.87	0.4
Iceland	+ 0.1	Apr	− 0.4	Q4	na	na	na	na	92.7	104	135	86.9	74.4	-0.5
Ireland	+ 32.5	Mar	− 1.1	Q4	na	na	89.1	85.7	1.08	1.18	1.57	–	0.87	0.1
Luxembourg	− 2.9	Feb	+ 0.9	Q4	na	na	99.8	98.0	1.08	1.18	1.57	–	0.87	2.2
New Zealand	+ 0.2	Apr	− 1.6	Q4	na	na	90.3	79.5	2.12	2.42	3.09	1.99	1.70	0.1
Norway	+ 24.7	Apr	+ 22.2	Feb	na	na	104.5	95.3	8.08	9.38	11.8	7.58	6.48	14.0
Portugal	− 13.6	Feb	− 9.8	Mar	na	na	89.9	88.6	1.08	1.18	1.57	–	0.87	-2.4

*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †1990=100, Bank of England. ‡OECD forecast.

Text refers only to the first 16 countries listed

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The Economist commodity price index

Jun 6th 2002
From The Economist print edition

1995=100

	May 28th	Jun 4th*	% change on one month	% change on one year
Dollar index				
All items	69.0	69.9	+ 2.8	– 0.4
Food	69.3	70.4	+ 4.4	+ 4.5
Industrials				
All	68.6	69.2	+ 0.7	– 6.5
Nfa†	69.0	69.3	– 0.0	– 5.3
Metals	68.2	69.0	+ 1.4	– 7.5
Sterling index				
All items	74.4	75.3	+ 2.9	– 4.1
Euro index				
All items	97.7	97.4	– 0.6	–10.5
Yen index				
All items	91.4	92.2	– 0.4	+ 2.7
Gold				
$ per oz	324.40	325.30	+ 4.1	+22.4
West Texas Intermediate				
$ per barrel	25.08	24.88	– 7.8	–10.4

* Provisional. † Non-food agriculturals.

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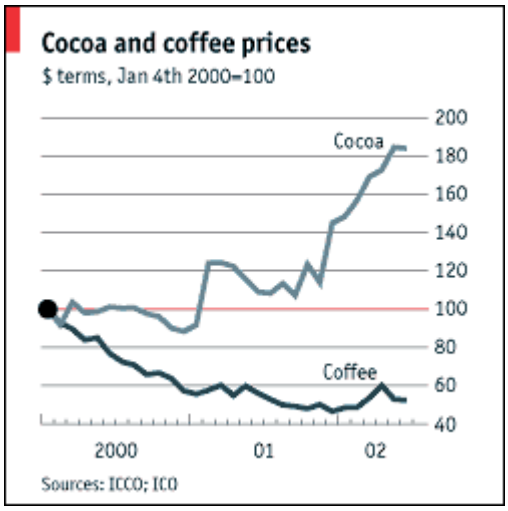
Cocoa and coffee prices

Jun 6th 2002
From The Economist print edition

Since January 2000 coffee and cocoa prices have gone their separate ways. Coffee has slumped amid a glut in supply; consumer stocks have doubled over the period. By contrast, cocoa has enjoyed its strongest rally for 20 years, as consumption has exceeded supply.



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Overview

Jun 6th 2002
From The Economist print edition

Indonesia's central bank cut interest rates by half a percentage point this week, as inflation continued to slow and the rupiah strengthened. Indonesian consumer prices rose by 12.9% in the year to May, compared with 13.3% in the year to April. Thanks largely to a fall in food costs, consumer prices in Taiwan fell by 0.3% in the year to May, after three consecutive monthly rises.

Peru's economy grew by an impressive 7.5% in the year to April, much faster than most analysts had expected.

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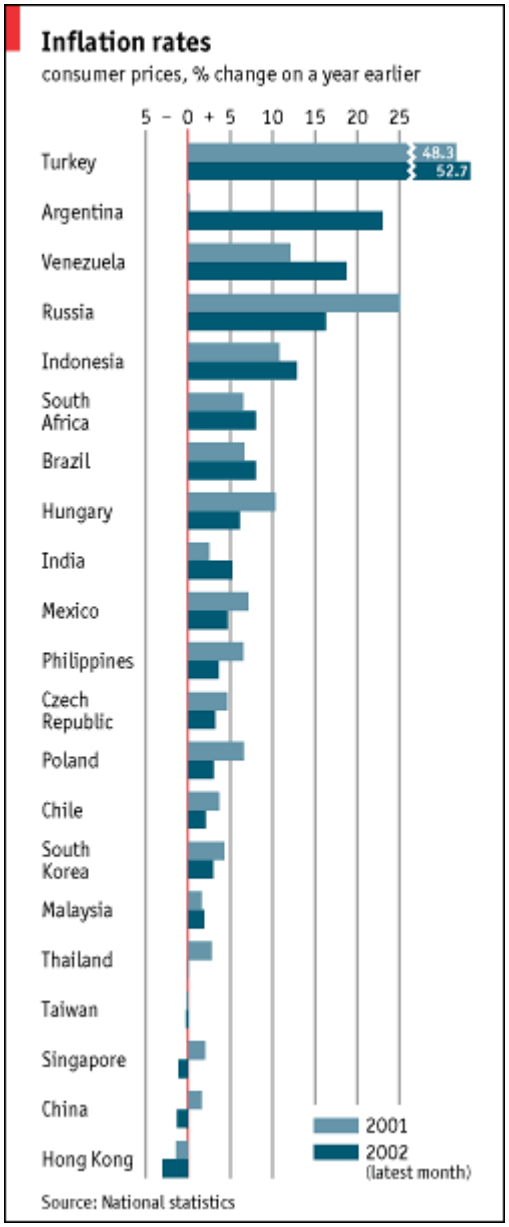
Inflation rates

Jun 6th 2002
From The Economist print edition

Stricken Argentina has lurched from deflation to high inflation. Prices fell in 2001, but the collapsing peso has led to price rises of 23.0% over the 12 months to May 2002. In Asia, deflation is apparent in mainland China, Hong Kong, Taiwan and Singapore, while in Thailand prices have been virtually flat. Inflation has eased in the Central and Eastern European countries shown in the chart.



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Economy

Jun 6th 2002
From The Economist print edition

	% change on year earlier						Latest 12 months, $bn				Foreign reserves* $bn, latest	
	GDP		Industrial production		Consumer prices		Trade balance		Current account			
China	+ 7.6	Q1	+12.1	Apr	– 1.3	Apr	+25.6	Apr	+21.2	2001§	226.7	Feb
Hong Kong	– 0.9	Q1	– 9.3	Q4	– 3.0	Apr	– 8.8	Apr	+12.0	Q4	110.9	Apr
India	+ 6.3	Q4	+ 2.4	Mar	+ 5.2	Mar	– 5.9	Mar	– 0.1	Q4	52.5	Apr
Indonesia	+ 2.5	Q1	– 2.2	Q3	+12.9	May	+26.6	Apr	+ 8.4	Q3	27.3	Apr
Malaysia	+ 1.1	Q1	– 3.5	Mar	+ 1.9	Apr	+13.5	Apr	+ 6.9	Q4	32.8	Apr
Philippines	+ 3.8	Q1	– 1.2	Mar‡	+ 3.6	May	+ 2.3	Mar	+ 5.0	Feb	14.6	Apr
Singapore	– 1.7	Q1	+ 8.1	Apr	– 1.1	Apr	+ 5.7	Apr	+18.4	Q1	76.6	Apr
South Korea	+ 5.7	Q1	+ 7.3	Apr	+ 3.0	May	+ 9.0	May	+ 7.0	Apr	107.6	Apr
Taiwan	+ 0.9	Q1	+ 7.5	Apr	– 0.3	May	+18.3	Apr	+22.0	Q1	132.9	Apr
Thailand	+ 2.1	Q4	+ 9.2	Apr	+ 0.1	May	+ 4.1	Apr	+ 6.0	Apr	32.9	Mar
Argentina	–10.7	Q4	–13.3	Apr	+23.0	May	+ 9.8	Mar	– 4.4	Q4	12.8	Mar
Brazil	– 0.7	Q1	– 3.8	Mar	+ 8.0	Apr‡	+ 4.9	May	–19.3	Apr	33.0	Apr
Chile	+ 1.7	Q4	+ 6.6	Apr	+ 2.1	May	+ 1.7	Apr	– 1.0	Q1	15.3	Mar
Colombia	+ 1.7	Q4	– 0.5	Feb	+ 5.8	May	+ 0.6	Mar	– 1.7	Q4	10.4	Apr
Mexico	– 2.0	Q1	– 7.6	Mar	+ 4.7	Apr	– 9.2	Apr	–16.8	Q1	46.2	Mar
Peru	+ 7.5	Apr	+ 0.3	Feb	+ 0.1	Apr	+ 0.1	Mar	– 1.0	Q1	8.7	Apr
Venezuela	– 4.2	Q1	+ 9.7	Jan	+18.7	Apr	+ 9.8	Q4	+ 2.1	Q1	6.6	Feb
Egypt	+ 4.9	2001†	+ 7.8	2001†	+ 2.5	Feb	– 8.6	Jan	– 0.1	Q4	12.6	Jan
Israel	– 4.2	Q1	– 6.9	Feb	+ 5.0	Apr	– 5.9	Apr	– 1.7	Q4	24.0	Apr
South Africa	+ 2.1	Q1	+ 3.9	Mar	+ 8.0	Apr	+ 3.7	Apr	– 0.2	Q4	6.0	Apr
Turkey	–10.4	Q4	+18.7	Mar	+46.2	May	– 8.0	Mar	+ 4.3	Feb	23.6	Apr
Czech Republic	+ 3.2	Q4	+ 4.1	Mar	+ 3.2	Apr	– 2.4	Apr	– 2.4	Q1	15.9	Apr
Hungary	+ 2.9	Q1	– 0.3	Apr	+ 6.1	Apr	– 2.3	Apr	– 1.6	Apr	10.1	Apr
Poland	+ 0.3	Q4	+ 0.2	Apr	+ 3.0	Apr	–11.1	Apr	– 0.8	Apr	26.2	Apr
Russia	+ 3.7	Q1	+ 4.3	Apr	+16.2	May	+45.0	Mar	+31.2	Q1	35.0	Apr
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Pakistan	+ 3.3	2001†	+16.3	Jan	+ 3.3	Apr	– 1.0	Apr	+ 0.3	2001†	4.0	Mar
Saudi Arabia	+ 1.7	2001§	na		nil	Feb	+37.5	2001§	+ 8.3	2001	17.6	Mar

*Excluding gold, except Singapore; IMF definition. ‡New series. †Year ending June. §Economist Intelligence Unit estimate.

Text refers only to the first 25 countries listed

Sources: National statistics offices, central banks and stock exchanges; Thomson Financial Datastream; Economist Intelligence Unit; Reuters; Warburg Dillon Read; J.P Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Garanti Bank; Deutsche Bank; *Russian Economic Trends*.

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Financial markets

Jun 6th 2002
From The Economist print edition

	Currency units			Interest rates	Stockmarkets	% change on		
	per $		per £	short-term	Jun 5th		Dec 31st 2001	
	Jun 5th	year ago	Jun 5th	% p.a.		one week	in local currency	in $ terms
China	8.28	8.28	12.0	na	1,525.2	–4.2	– 10.9	– 10.9
Hong Kong	7.80	7.80	11.4	1.86	11,402.4	–0.2	nil	nil
India	49.0	47.0	71.3	6.59	3,255.5	+3.0	– 0.2	– 1.8
Indonesia	8,925	11,195	12,989	16.24	520.5	nil	+ 32.8	+ 54.7
Malaysia	3.80	3.80	5.53	3.25	746.9	–2.1	+ 7.3	+ 7.3
Philippines	50.9	50.7	74.1	6.50	1,311.7	–0.9	+ 12.3	+ 13.9
Singapore	1.80	1.81	2.61	0.88	1,654.0	–1.8	+ 1.9	+ 4.7
South Korea	1,214	1,286	1,767	4.83	809.6	–3.1	+ 16.7	+ 26.2
Taiwan	34.0	34.1	49.4	2.45	5,599.4	–0.4	+ 0.9	+ 4.0
Thailand	42.5	45.3	61.9	2.13	411.1	+0.5	+ 35.3	+ 40.6
Argentina	3.63	1.00	5.28	49.80	292.4	–13.8	– 1.0	– 72.7
Brazil	2.61	2.38	3.80	18.19	12,589.8	–3.0	– 7.3	– 17.9
Chile	662	607	963	3.84	5,103.7	–0.8	– 5.4	– 5.5
Colombia	2,334	2,303	3,397	9.01	1,179.0	+1.6	+ 10.1	+ 7.4
Mexico	9.73	9.12	14.2	7.00	6,974.9	–2.2	+ 9.5	+ 3.1
Peru	3.47	3.55	5.05	1.89	1,232.1	–1.4	+ 4.8	+ 4.1
Venezuela	1,081	715	1,573	37.65	7,445.0	–0.4	+ 13.3	– 20.6
Egypt	4.63	3.87	6.74	7.19	5,278.6	–1.8	+ 0.1	– 1.1
Israel	4.96	4.14	7.22	3.55	377.3	+1.1	– 15.6	– 24.9
South Africa	9.9	8.09	14.5	11.85	11,279.8	–0.7	+ 8.0	+ 30.3
Turkey	1,440,500	1,170,000	2,096,504	43.00	10,383.4	–3.9	– 24.7	– 23.9
Czech Republic	32.5	40.3	47.3	3.81	460.0	–1.1	+ 16.6	+ 27.5
Hungary	258	296	375	9.21	8,143.8	–0.4	+ 14.2	+ 21.8
Poland	4.02	4.00	5.86	9.64	15,699.3	–0.1	+ 12.8	+ 10.8
Russia	31.4	29.2	45.7	23.00	387.2‡	+1.6	+ 53.4	+ 48.9
EMF (MSCI)*	1.00	1.00	1.46	na	346.5	–1.9	na	+ 9.2
EMBI+†	1.00	1.00	1.46	na	210.9	–1.4	na	+ 5.3

*Emerging Mkts Free. †J.P. Morgan Chase's Emerging Mkts Bond Index Plus. ‡ In $ terms.

Sources: National statistics offices, central banks and stock exchanges; Thomson Financial Datastream; Economist Intelligence Unit; Reuters; Warburg Dillon Read; J.P Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Garanti Bank; Deutsche Bank; *Russian Economic Trends*.

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